

Final Report on MAPPR Project:

The Detroit Living Wage Ordinance: Will it Reduce Urban Poverty?

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Detroit's Living Wage Ordinance

The Detroit Living Wage Ordinance passed in the fall of 1998. As in other major urban areas passing living wage ordinances in the 1990s, Detroit's ordinance seeks to reduce urban poverty. The ordinance seeks to accomplish this by imposing a substantial minimum wage requirement on any business or other entity that either has a contract to provide services to the city or has a grant from the city for the purpose of economic development or job growth; the value of the contract or grant must exceed \$50,000 for the ordinance to be binding.

The ordinance's goal of reducing poverty is made explicit in the linkage of its minimum wage requirement to the federal government's definition of poverty. Specifically, for a contractor or grantee that does not provide fully paid, comprehensive family medical coverage, the minimum wage on an annual basis must equal 125 percent of the federal poverty level for a family of four. The requirement falls to 100 percent of the poverty line for contractors or grantees meeting the health insurance requirement. As of March 2000, the required wage was \$8.53 with health insurance, and \$10.66 without health insurance.

Living Wages Nationwide

Since December 1994, many cities in the United States have passed living wage ordinances. These ordinances typically mandate that businesses under contract with the city, or in some cases receiving assistance from the city, must pay their workers a wage sufficient to support a family financially. Baltimore was the first city to pass such legislation, and nearly 40 cities and a number of other jurisdictions have followed suit.

Like Detroit's, living wage laws have three prominent features. First, all living wage ordinances feature a minimum wage floor that is higher—and often much higher—than the traditional minimum wages set by state and federal legislation. Second, living wage laws frequently link the wage floor to a poverty threshold, for example requiring a wage that would

get a family of four with one full-time worker to the poverty level. Third, coverage by living wage ordinances is far from universal. The most common specification of coverage—and also the most narrow—is restricted to companies under contract with the city. Some living wage laws also impose the wage on companies receiving business assistance from the city, while the least common feature is for cities to impose the requirement on themselves, covering city employees. Regardless, this narrower coverage contrasts with minimum wage laws, which cover nearly all workers. Thus, living wage laws impose high wage floors, have an anti-poverty objective that is often reflected in the choice of the wage floor, and apply to what may constitute a relatively narrow group of workers.

Prior to the research described in this final report, there has been no analysis of the actual effects of living wages on the expected beneficiaries—low-wage workers and their families. Given the fact that a large number of cities have passed living wage laws recently, and that campaigns for such laws are under way in many other cities, it is an opportune time to present research analyzing the effects of these laws. Only then can policy-makers, employer organizations, labor unions, and voters make informed judgments regarding the merits of this increasingly popular policy innovation.

Research Objectives

Resources from the MAPPR were used to support research aiming to present such evidence. Three papers have been written, which together address a broad-ranging set of questions intended to make a significant start on developing a research agenda on living wages. In particular, this research aims to provide evidence relevant to (i) understanding how living wage laws work and how policy analysts can study their impact, (ii) assessing whether living wages achieve their primary policy goal, and (iii) understanding the incentives of actors in the

economic and political arena to push for living wage laws. Specifically, the following questions are addressed:

- Do living wage laws have any “teeth,” raising wages for at least some low-wage workers?

Are living wage laws sufficiently broad and strongly enforced to have effects that can be detected in the data available to policy analysts?

- Do living wage laws achieve their stated policy objective of improving economic outcomes for low-wage workers and low-income families? Are any wage gains for low-wage workers offset by employment or hours reductions? Do living wage laws reduce urban poverty?

- Given the stated anti-poverty goal of living wage campaigns, why do the laws frequently narrowly restrict coverage to city contractors, rather than imposing wage floors for broad groups of workers? Do these narrow coverage restrictions help other economic actors—in particular unionized municipal workers—who stand to gain from living wages?

While the Detroit living wage was to some extent the catalyst, the empirical analysis conducted in this research project exploits all of the city-level living wage ordinances in the United States in estimating the effects of these laws, in order to obtain as reliable and precise a set of estimates as possible. However, at the end of this document, some tentative results specific to Detroit and a control sample of Michigan cities is discussed.

Principal Research Findings

The following principal findings emerge from the empirical analysis of living wage laws in the United States.

- First, there are sizable positive effects of living wage ordinances on the wages of low-wage workers in the cities in which these ordinances are enacted. At the same time, the magnitudes of the estimated wage effects are larger than would be expected based on the limited coverage of the most common type of living wage laws—covering city contractors. It turns out that the large wage effects are driven by cities in which coverage of living wage laws is more broad—specifically, cities that also impose living wages on employers receiving business assistance from the city. Thus, existing analyses of the likely effects of living wage laws based on narrow coverage and ignoring business assistance provisions may be quite misleading, and it may be appropriate to think of at least some living wage ordinances—in particular those with business assistance provisions—as operating considerably more broadly than wage floors imposed on city contractors.

- Second, while living wage laws raise wages of low-wage workers, they also appear to generate some employment reductions among the affected workers, with the negative employment effects corresponding quite closely to the wage increases. Thus, the positive impact of living wage laws on the wages of low-wage workers is accompanied by disemployment effects among the potentially affected workers, pointing to a trade-off between wages and employment, exactly as economic theory would predict.

- Third, while economic theory offers some guidance as to the expected trade-offs regarding higher mandated wage floors, it makes no predictions regarding the effects of living wage laws on family incomes or poverty. The impact ultimately depends on the family incomes of those workers who experience wage gains and those individuals who experience reduced employment

prospects. The evidence indicates, however, that living wage ordinances result in moderate reductions in the likelihood that urban families live in poverty.

- Fourth, the evidence is consistent with living wage laws reducing the incentives for cities to contract out work that would otherwise be done by municipal employees, hence increasing the bargaining power of municipal unions and leading to higher wages. As indirect evidence, labor unions—especially those representing municipal workers—are very active in the movement to pass living wage laws. More directly, the wages of unionized municipal workers are increased as a result of living wages. Evidence that unionized municipal workers gain from living wage laws does not imply that living wages offer no assistance to low-wage workers or low-income families. But that fact that an unintended beneficiary advocating for living wage laws also gains from them raises the possibility that alternative policies intended to achieve the goal of reducing urban poverty may well be more effective.

The combined evidence suggests that the cup is either half-full or half-empty, depending on one's point of view. Policy-makers—whatever their own view of the merits of living wage laws—ought to be encouraged by the findings that living wage laws have their most “direct” intended consequence—raising wages of low-wage workers. Economists will nonetheless find it reassuring that the wage increases engineered by living wage laws result in some trade-offs in the form of lower employment. Advocates of living wages should be pleased by the results indicating that living wage laws reduce urban poverty. And finally skeptics will likely find satisfaction in the evidence that unionized municipal workers reap gains from living wages.

Note, however, that none of these conclusions are necessarily in conflict. Living wage laws can in principle engender some employment losses, but coupled with wage increases, and

depending on the magnitude and incidence of each of these effects, help the poor. And higher-wage unionized municipal workers can gain at the same time that low-income families gain.

A cautious reading of the evidence, then, suggests that on net living wages may provide some assistance to the urban poor. But the evidence that other workers who are not the intended beneficiaries also gain emphasizes that there is no basis as yet for concluding that living wages provide the best means of helping the urban poor, and that there is some basis for skepticism regarding this point. Policy-makers contemplating implementing living wage laws, and policy analysts assessing living wage laws, should give full consideration to comparisons among alternative methods of reducing poverty.

Limited Results for Detroit

As discussed earlier, the empirical analysis exploits all of the city-level living wage ordinances in the United States in estimating the effects of these laws, in order to obtain as reliable and precise a set of estimates as possible. Nonetheless, it is possible to estimate the models reported in the three papers resulting from this research project (cited below) using only cities in Michigan. In this case, the effects of living wages are identified from how changes in Detroit in periods when the living wage increased compare with changes in other Michigan cities (actually, “standard metropolitan statistical areas,” or SMSAs) in the same period. For example, if poverty in Detroit fell more sharply than elsewhere in Michigan in a period when the living wage was being implemented or increased, the empirical approach would show that the Michigan living wage reduced poverty.

However, these estimates must be interpreted very cautiously, and in my view should not be used for the purposes of drawing any firm policy conclusions. Because there is only one city in this Michigan-only sample that imposes a living wage, it is very difficult to sort out the effects of living wages from the effects of other changes over the same period that might have

been driving labor market outcomes in Detroit relative to other Michigan cities. In a sense, this is true in the results for the United States as a whole, as well. But because in that analysis there are many cities in the “treatment group” of those raising living wages, it seems likely that city-specific changes roughly average out. In contrast, having only one city with a living wage does not permit any “averaging” across different types of cities to avoid the influence of idiosyncratic factors.

With these provisos in mind, Table 1 reports results from an analysis of the effects of living wages on wages of low-wage workers. A similar analysis for the U.S. as a whole appears in the paper “Detecting Effects of Living Wage Laws,” and that paper provides a full discussion of the equation from which the estimates in Table 1 are derived. Here, the results are simply summarized. The estimates in column (1) indicate that living wages are associated with sharp increases in wages of the lowest-wage workers—those whose wages are in the bottom decile of the wage distribution. In contrast, the estimates in the other columns generally indicate little impact of living wages on the wages of higher-wage workers, which is as expected. However, the estimates in column (1) are implausibly large. For example, looking at the effect after 12 months, the estimate of 28.01 implies that a 50-percent increase in the living wage raises wages of low-wage workers by 14 percent. This estimate is roughly four times as big as that obtained using the data for the United States as a whole. At most what one should take away from this table is that the data for Detroit’s living wage (compared to the rest of Michigan), like for the United States as a whole, indicate positive effects of living wages on the wages of workers at the bottom of the wage distribution.

Table 2 reports estimates of employment effects of living wages. These estimates (and those in Table 3) are the focus of the paper “Do Living Ordinances Reduce Urban Poverty?” In the data for the U.S. as a whole, the positive wage impact for low-wage workers was offset

partially by employment reductions for these same workers. However, as column (1) of Table 2 shows, no disemployment effects appear to flow from the Detroit living wage. Given that the positive wage impact was so large, and that there was a disemployment effect in the data for the United States as a whole, this is difficult to believe, and suggests instead that something other than the living wage is driving the estimated effect of the living wage on wages. One possibility is that economic conditions were improving more rapidly in Detroit than in the rest of Michigan during the sample period. Consistent with this conjecture, between 1996 and 2000, among the cities for which unemployment rates can be calculated, with the exception of Jackson the unemployment rate fell fastest in Detroit. This highlights the inherent problem of inferring the effect of a policy change that occurred in only one location.

Finally, Table 3 turns to the impact of the living wage on poverty, measured first in terms of earnings only, and then in terms of total income (as in “official” poverty classifications). These estimates reveal that living wages decrease the probability that families have earnings below the poverty line, but not the probability that total income is below the poverty line. In contrast, in the data for the United States as a whole, living wages reduce the probability that families are poor, but do not significantly reduce the probability that families have earnings below the poverty line. The paper cited above discusses possible reasons for differential effects on earnings and total income. Nonetheless, the combined evidence tends to suggest that living wages may have some beneficial effects on low-income/poor urban families.

Papers Resulting from the Research

Three papers have resulted from this research, copies of which are available by contacting David Neumark at neumarkd@msu.edu. The papers are as follows:

1. “Detecting Effects of Living Wages,” co-authored with Scott Adams (a former Ph.D. student in the Department of Economics at Michigan State), is under review at Industrial Relations.
2. “Do Living Wage Ordinances Reduce Urban Poverty?,” also co-authored with Scott Adams, is under a second review at Journal of Human Resources.
3. “Living Wages: Protection For or Protection From Low-Wage Workers,” will be submitted to the Journal of Political Economy early this summer.

Presentations Based on the Research

Public Policy Institute of California

University of California, Berkeley

University of Washington

University of California, Santa Cruz

American Economic Association Annual Meetings, New Orleans

Table 1: Contemporaneous and Lagged Effects on Log Wages of Workers in Various Percentile Ranges of the Wage Distributions of SMSAs, Michigan Residents Only

Centile:	<u>Effects for different centile ranges</u>			
	≤ 10 (1)	10 – 25 (2)	25 – 50 (3)	50 – 75 (4)
Specification 1: Living wage	14.82** (7.32)	6.30 (4.85)	4.74 (4.81)	6.39 (4.46)
Specification 2: Living wage 6 months ago	19.11** (8.07)	7.92* (4.80)	9.13* (5.08)	8.64* (4.85)
Specification 3: Living wage 12 months ago	28.01** (10.13)	4.67 (5.85)	3.40 (6.21)	4.31 (5.79)
Sample size	1,544	2,028	3,246	3,382

Reported are the estimated effects of minimum wages and living wages effective in an SMSA on the log wages of workers in various percentile ranges of SMSAs. Robust standard errors are reported in parentheses. Specifications include dummy variables for each month in the sample, so minimum wage effects are not identified. All estimates are multiplied by 100. Thus for these log-log specifications, elasticities are given by the coefficients divided by 100. The sample includes data for each month from 1996-2000. Data from an SMSA is included for a month if there are at least 25 observations. Thus, the sample excludes individuals in small SMSAs and those not living in SMSAs. A total of 7 SMSAs are used in the analysis, including Ann Arbor, Detroit, Flint, Grand Rapids-Muskegon-Holland, Kalamazoo-Battle Creek, Lansing-East Lansing, and Saginaw-Bay City-Midland. Observations for which allocated information is required to construct the wage variable in the CPS are dropped. In all tables reporting regression results, a ‘**’ superscript indicates that the estimate is significantly different from zero at the five-percent level, and a ‘*’ superscript at the ten-percent level.

Table 2: Contemporaneous and Lagged Effects on the Probability of Employment in Various Ranges of the Imputed Wage Distributions of SMSAs, Michigan Residents Only

Centile:	<u>Effects for different centile ranges</u>			
	≤ 10 (1)	10 – 25 (2)	25 – 50 (3)	50 – 75 (4)
Specification 1: Living wage	4.29 (5.31)	12.86** (4.73)	7.11** (3.19)	-2.39 (2.95)
Specification 2: Living wage 6 months ago	4.04 (5.67)	11.81** (5.28)	5.16 (3.36)	-1.99 (3.09)
Specification 3: Living wage 12 months ago	-1.41 (6.37)	18.15** (6.11)	4.03 (4.00)	-4.03 (3.56)
Sample size	3,970	5,633	9,400	9,514
Mean percentage employed	52.67	59.06	66.32	77.93

Reported are the estimated effects of the minimum wage and living wage effective in an SMSA on the employment of individuals in the range of an SMSA's imputed wage distribution specified at the top of each column, using linear probability models. All estimates are multiplied by 100. Because the living wage is expressed in logs, elasticities are given by the coefficient divided by the mean percentage reported in the last row of the corresponding column. See notes to Tables 1 for additional details. In addition to the SMSAs listed in Table 1, in this table data for Jackson are also used.

Table 3: Contemporaneous and Lagged Effects on the Probability that Family Earnings or Income Fall Below the Poverty Line, Michigan Residents Only

	Effects on the probability that families have <i>total earnings</i> <u>below the poverty line</u>		Effects on the probability that families have <i>total income</i> <u>below the poverty line</u>	
	(1)	(2)	(3)	(4)
Specification 1:				
Living wage (December of prior year for ADFs)	-11.65** (3.67)	-6.49 (4.01)	-2.23 (2.62)	-.490 (2.37)
Specification 2:				
Living wage 6 months ago (June of prior year for ADFs)	-12.40** (4.32)	-9.26** (4.64)	-4.74 (3.32)	-3.32 (3.19)
Specification 3:				
Living wage 12 months ago (January of prior year for ADFs)	-12.78** (4.45)	-9.54** (4.78)	-4.89 (3.42)	-3.43 (3.29)
Data set	ADF	ADF	ADF	ADF
Sample restrictions	>=25 per cell	>=25 per cell	>=25 per cell	>=25 per cell
Years that sample covers	96-99	95-99	96-99	95-99
Number of observations	4,979	6,200	4,979	6,200
Mean percentage below poverty	29.13	29.16	13.60	13.94

Reported are the estimated effects of minimum wages and living wages effective in an SMSA on whether a family's earnings or income are below poverty, using linear probability models. Robust standard errors are reported in parentheses. All estimates are multiplied by 100. Because the living wage is expressed in logs, elasticities are given by the coefficient divided by the mean percentage reported in the last row of the corresponding column. Given that the ADF surveys are conducted in March and information on family earnings and income refer to the prior calendar year, the applicable contemporaneous and lagged minimum and living wages are noted in parentheses in the left-hand column. The regressions include year dummy variables, so minimum wage effects are not identified. Observations for which allocated information is required to construct the total earnings variable or the total income variable in the CPS are dropped for the relevant analyses. See notes to Tables 1 and 2 for additional details. The same SMSAs used in Table 2 are used in this table.