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The “Living Wage”

By Fred E. Foldvary

There is a proposal in San Francisco, California, to establish a minimum wage of $11 per hour for companies that provide services or lease land from the city. Those who favor this argue that the high cost of living in San Francisco warrants requiring this wage floor so that those workers can afford housing and other living expenses.

Starting with Baltimore in 1994, some 30 local governments in the USA have enacted such "living wage" laws in which firms which contract with the government pay their workers no less than the set wage. In San Francisco, the proposed wage of $11 per hour is almost double the $5.75 minimum wage in California. According to the "Economic Letter" by economist Rob Valletta published by the Federal Reserve Bank of San Francisco, October 15, 1999, the highest "living wage" amount is currently San Jose, which requires a wage of $9.50 with and $10.75 without fringe benefits.

If a company were awarded a contract with a city without any competitive bidding, then if it is earning monopoly profits, the higher wage will shift revenue from profits to wages. But even then, the higher cost of labor will increase the firm's marginal cost, the extra cost from providing more services. As any student of economics knows, this extra cost reduces the quantity at which the firm maximizes profits, resulting in less service to the public. If the quantity does not go down, then the quality will.

If the firms obtained the lease or contract by competitive bidding, then they don't have monopoly profits. The extra cost of labor cannot be absorbed by the firm's owners, but must be passed on to the government. The gains obtained by the workers are offset by losses to the taxpayers, the public, and the unlucky workers who lose their jobs. Companies will reduce their bids for leased land and increase their bids for contracted services. The loss of city revenue will either reduce city services or result in higher taxes.

The least skilled workers will also suffer. If the firm must pay $11 per hour, the firm can hire workers whose market wage is already $11. They have better skills and working attitudes and habits than those whose pure market wage would be $5.75 or less. Since firms will tend to hire the more productive workers, the living wage law will hurt the poorest and least able workers, just those workers that the law is intended to help.

In addition, workers whose wage is raised from $5.75 to $11 will lose some tax benefits, such as the earned income tax credit. So their net gain will be less than the gross gain from the wage increase. The overall loss from higher taxes to the State and federal governments will result in an outflow of funds and resources from San Francisco to those governments. So there may not be much overall net economic improvement for the city.

If many workers in the city were to receive a net increase in wages, this extra money would be a pot of gold for their landlords. Those landlords not under rent control would be able to raise the rents of their low-income tenants, since if the tenant could afford to live there before the raise, he can also afford it if the higher rent brings him back to the same after-rent income. Those tenants in rent-controlled apartments would get a double subsidy, rent and wages, increasing the inequality between those with privileges and those who were not lucky enough to get the government grants.

So the effect of local "living wage" laws are generally higher taxes, higher rents and fewer services for the residents, greater inequality, and not that much improvement in the well-being of the poorest workers and of the city community. The superficial appeal of this programs that only treats the effects of poverty dissolves when subjected to economic analysis.

The fundamental reason why the least-able workers have low wages is that their labor has a low productivity and that a large chunk of their wage is taken away by taxes. **The best remedy is to deal with the root cause of the problem: change the school system to raise the educational level of the students, and stop taxing wages when earned or spent. Shift the tax base from wages to land rent.** These reforms would raise the pure market wages of the least able workers. Then employers would willingly pay the higher wages because the workers are worth it.

Artificial mandates impose costs on taxpayers and the public and ultimately are less helpful to the poor than they seem at the surface. They are popular only because an ignorant public often sees only the superficial surface of policy. What we learn from economics is the reality beneath the superficial appearance. If the public had economic enlightenment, it would demand real remedies rather than superficial and ineffective nostrums like the "living wage."

-- Fred Foldvary