

Do Living Wages Accomplish Their *Intended* Purpose?

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Key Issues

Much of the economic focus is on the policy's ***unintended consequences***:

- Do living wages cause unemployment?
- Do firms move out of a city to avoid the living wage?
- Do firms subcontract to avoid paying the living wage?
- Do consumer prices increase to pay for the living wage?

Key Issues

Economists focus relatively less attention on the policy's ***intended consequences***. This discussion will focus on whether a living wage achieves its intended consequences.

Key Issues

Living wage is often motivated by concerns about poverty alleviation. Natural questions:

- What “*tax rates*” do low-income households face?
- Should *income* be defined as “cash income” or something else?
- How does the living wage affect *total family income* and earnings?
- Is the living wage *well-targeted*?

Key Issues

Much of this presentation will draw on two recent studies:

Toikka, Yelowitz, and Neveu (forthcoming 2004, *Economic Development Quarterly*)

Yelowitz and Toikka (work-in-progress, discussion paper for *Employment Policies Institute*)

Tax Rates

Many poor households take up transfer programs:

- Temporary Assistance to Needy Families (TANF)
- Food Stamps
- Public Housing
- Medicaid
- Numerous smaller programs

**These program impose high tax rates
(illustrated in table 1)**

Table 1

Earnings and benefits after four months on job for a mother with two children with day care expenses, 1996 – Philadelphia, Pennsylvania.

| Earnings | EITC | AFDC | Food Stamps | Medicaid \$3307 | Eligible for public housing | Housing subsidy, 2 bedrooms | Total Income |
|----------|------|------|-------------|-----------------|-----------------------------|-----------------------------|--------------|
| 0 | 0 | 5052 | 2722 | Yes | Yes | 8136 | 19217 |
| 5000 | 2000 | 2492 | 2590 | Yes | Yes | 7224 | 20730 |
| 10000 | 3556 | 0 | 2438 | No | Yes | 6024 | 18253 |
| 15000 | 2842 | 0 | 1538 | No | Yes | 4824 | 18436 |
| 20000 | 1789 | 0 | 0 | No | Yes | 3624 | 18123 |
| 25000 | 736 | 0 | 0 | No | No | 0 | 16929 |
| 30000 | 0 | 0 | 0 | No | No | 0 | 19837 |
| 50000 | 0 | 0 | 0 | No | No | 0 | 34188 |

Notes: In adding the numbers across each row to get total income, negative values are in parentheses. *Social Security taxes, federal and state income taxes, and work expenses are also factored into the calculations but not included to save space.*

Tax Rates

Assuming **full take-up** of programs:

- Average tax rate on first \$30k of earnings was **98%**
- The ***composition*** of income changes
- Poverty rates change based on cash definition

Tax Rates

- These tax rates are important in the Atlanta context
- ***Santina Story*** is a 33-year-old mother of three, who worked full time and earned \$6.75 an hour at the Crowne Plaza Hotel in Atlanta
- She likely faces tax rates of 75% on additional earnings

Defining Income

The ***composition*** of income changes in Table 1, which leads to changes in poverty rates based on the cash definition.

- At \$0 earnings, 26% of total income was cash
- At \$10,000 earnings, 54% of total income was cash
- At \$22,000 about 83% of total income was cash (not shown)

Defining Income

- Although total incomes are relatively unchanged at \$0, \$10,000, or \$22,000 in earnings, ***the poverty classification does change***
- Poverty definition is based on cash-income
- ***Illusory effect*** – “well-being” not changed much

Effect on Family Income

In Yelowitz and Toikka (work-in-progress), we compare vulnerable households in cities that implemented a living wage to those that did not.

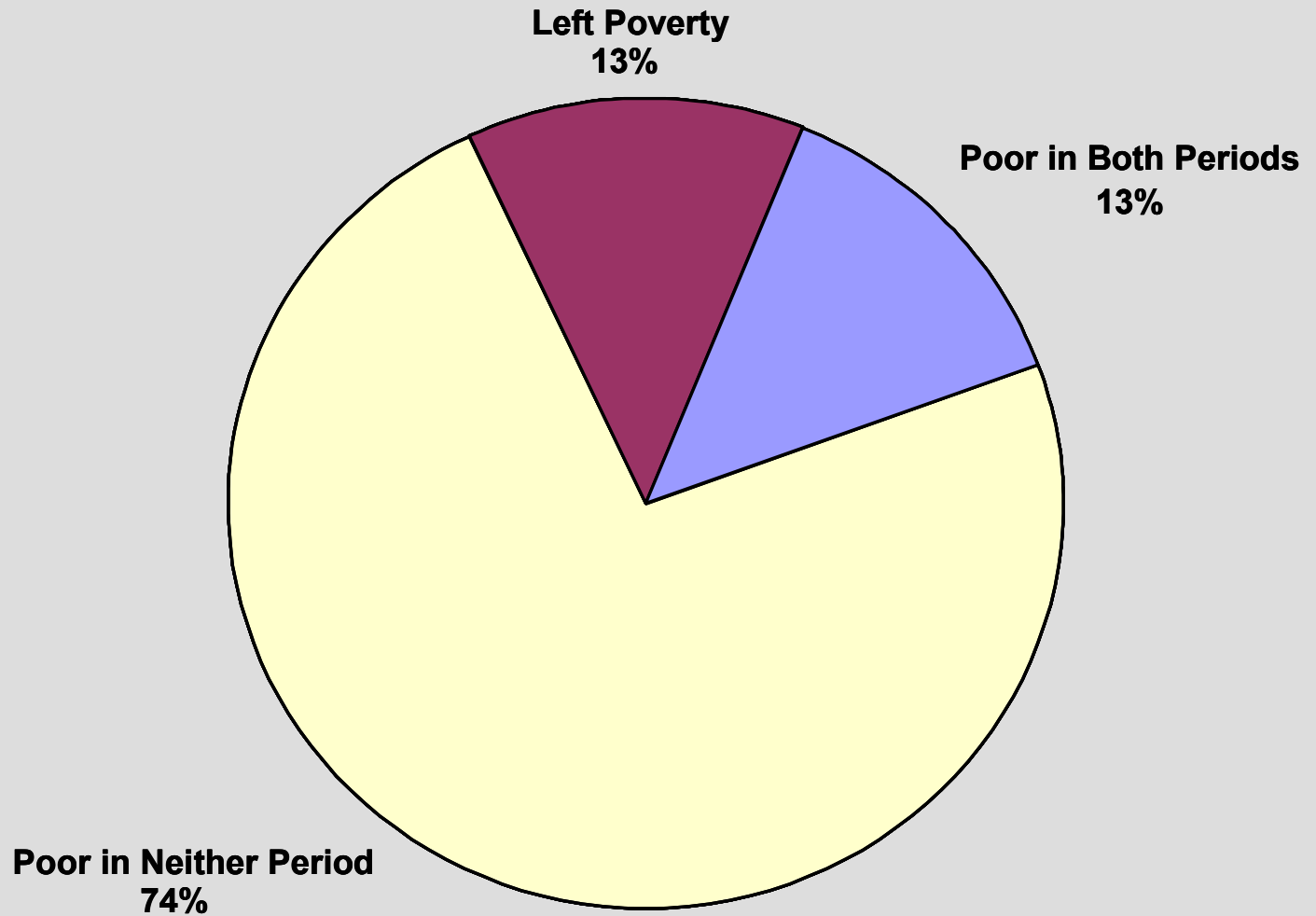
The living wage had statistically insignificant effects on household total income and earnings.

Moreover, for every \$1.00 of increased earnings, cash transfers fell by \$0.44.

Targeting

- Toikka, Yelowitz, and Neveu simulate the effects of a living wage across a number of large cities
- Of those affected by living wage, **75% did *not* live in poverty**
- Of those affected by living wage, **40% had incomes *greater than 200%* of poverty line**

Figure 2. Fraction of increased wages received by household poverty status



Targeting

- The data suggests that even using a cash-based measure of poverty, the living wage is not well-targeted
- Living wage targets *individual earnings*, not *family income*
- May benefit single individuals, teens, others who are not “at-risk”

Alternatives

Are there *alternatives* to the living wage that lead to more desirable outcomes? One popular proposal is a state-level *Earned Income Tax Credit (EITC)*.

Center on Budget and Policy Priorities reports:

- Twelve states have refundable state-EITCs
- Five states have non-refundable EITCs
- No state in the South currently has one

Alternatives

EITC often is not counted as income for transfer programs. EITC, therefore, does not “crowd-out” transfer assistance which is composed of both federal and state dollars.

Conclusions

My research indicates that the living wage is a very blunt policy instrument for achieving its policy objectives.

A better solution is a state Earned Income Tax Credit. EITC could target family income rather than earnings, and could target vulnerable households in a way the living wage cannot.

Conclusions

I am delighted to answer questions, either today or in the future.

- Aaron Yelowitz's email: aaron@uky.edu
- The full studies (and data) available at: <http://gatton.uky.edu/faculty/yelowitz/>
- Thank you!