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## Citywide Minimum-Wage Rules: Living Wages or Killing Jobs? *September 25, 2006 6:24 p.m.*

On Sept. 11, Chicago Mayor Richard M. Daley used the first veto of his 17-year tenure to reject an ordinance aimed at forcing big retailers to pay wages of \$10 an hour and health benefits equivalent to \$3 an hour by 2010. The veto is important to Wal-Mart Stores Inc., which plans to open its first store in Chicago late this month in the economically depressed 37th ward.

Some cities such as Santa Fe, San Francisco and Washington, D.C., have such "living wage" laws, which opponents argue keep some retailers out of town and boost unemployment among low-wage workers. Supporters counter that such measures can help ensure adequate wages for workers.

The Online Journal asked academics Richard Epstein, a professor and director of the University of Chicago's Law and Economics program and Michael Reich, director of the Institute of Industrial Relations and an economics professor at the University of California at Berkeley, to discuss their different views on local minimum wage rules. What do you think? Share your comments on our [discussion board](#).

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**Richard Epstein writes:** Mayor Richard M. Daley is not known as an arch defender of laissez-faire economics, but not withstanding that regrettable deficiency, he did the right and courageous thing in vetoing Chicago's living-wage ordinance.

In doing so he understood what too many Chicago aldermen fail to grasp, which is that people, including sophisticated corporate executives, respond to incentives. Oddly enough that simple truth seemed to escape many of the aldermanic defenders of the initiative, who held fast to the sunny illusion that Chicago is such an attractive market for Wal-Marts, Target, and other big-box stores that they are sure to come here no matter what wage structure the city council imposed. Before making that rash statement, they should have asked this question first: Why is it that Wal-Marts hadn't already started in Chicago, if its market offers such irresistible lures?

The answer is that big businesses, like everyone else, will go where their costs are low, and where they are treated as a good neighbor and not as a potential felon. Ironically though, the damage may be done even though the mayor's veto was not overridden by the city council. Daley will not be mayor forever, and even though this piece of legislation bit the dust, the next one might not. So why invest in immovable assets if the city council could pass another version of the living-wage ordinance once the stores are up and open for business?



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**Michael Reich writes:** Three quick points:

First, most large retailers in the U.S. already have saturated the consumer market in suburban areas, in part because in many states each suburb competes with other suburbs for sales tax revenue and so they provide subsidies to local retail development. Retailers want to increase their market share -- that is the best way to maximize their long-run profit -- and the opportunities now are greatest in the underserved areas of central cities. Despite what some retailers might say, they have preferred to be located near consumers even when local costs are a bit higher. Otherwise there would be no retailers at all in our central cities. For systematic evidence that retailers are not fleeing and indeed are continuing to come into cities with higher minimum wages, such as San Francisco and Santa Fe, see [Do Businesses Flee Citywide Minimum Wages?](#)

Second, the range of economists' estimates of minimum wage effects on employment have shifted substantially in the past decade. Studies using data from the 1990s find either very small negative effects on employment or find zero or positive effects. My own work -- with data from businesses in San Francisco before and after the citywide minimum wage was introduced -- finds zero effects on overall employment, with upgrading of some jobs from part-time to full-time status. Studies of Santa Fe businesses also find no employment effect. For more details on my San Francisco study, see "[The Economics of Citywide Minimum Wages.](#)"

Third, it does make sense that higher minimum wages need not reduce the number of jobs, once we take into account job vacancies, recruitment and retention costs, and other employee turnover issues that are familiar to all employers. Low-wage employers typically experience turnover of 100% or more per year; they are constantly hiring and cannot fill all their vacancies. A higher minimum wage attracts more workers and encourages them to stay longer with their employer, so the result is fewer vacancies, not fewer jobs.

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**Richard Epstein writes:** Let me respond to Michael's point first with a general and second with some specific observations. On a general level, the evidence that Michael cites, even if true, is not directed toward the Chicago big-box ordinance, which has two features that are not found in other minimum wage laws. First, the wage and health care boosts are much higher than those in the other communities which he has referred to, and second they are limited to big-box firms, and exclude all other retailers.

Even if one thought, as I do not, that changes in minimum wage laws have little effect on employment, it is clear that this statute will have some differential effect on which retailers, selling what goods at what prices, decide to remain in Chicago. We have strong testimonial evidence that the large box companies will stay out, which means that the local market is left to other merchants whose higher labor costs guarantee a higher price structure.



On some particulars, the saturation point is wholly unpersuasive with respect to a long and skinny city like Chicago with a high boundary-to-area ratio. Here it is easy for suburban stores to poach on city residents who live as near to them as they do to many urban stores. The common pattern here is for people to make large trips to the big-box stores once or twice a month in order to avoid the local merchants who charge higher prices. Merchants may come to some cities with higher minimum wage, but if they do they will surely design business plans that make less use of unskilled labor than they would have in the absence of minimum wages. One simple interpretation of the data is that firms that are less dependent on minimum-wage workers will flourish while others do not. But this hardly helps the unskilled workers who lose twice. They are shut out by the minimum wage and have to pay higher prices for the goods they want. So they will just go elsewhere.

Third, I do not think that the turnover issues offer any justification for a minimum wage law. If the turnover costs are this high, then an employer can voluntarily reconfigure its work force by using higher wages as an offset to higher turnover. There is no reason to mandate actions that work in employer's self interest. And there is certainly no reason to apply this paternalist rationale to big box employers to the exclusion of everyone else, which is what the Chicago ordinance does.

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**Michael Reich writes:** On the specifics of the Chicago ordinance, its higher minimum wage would increase in steps until 2010. By then the Santa Fe and San Francisco minimums will be very close to the same level as in Chicago, and San Francisco has also just implemented a health-care policy on top of the minimum wage. So these cases are very comparable.

In any case, I understand that a modified proposal for Chicago will be introduced, so there will be further give and take, just as in many other jurisdictions. We need not limit ourselves to this specific example.

The analysis of citywide minimum wages always should be based on scientific evidence, not on any individual's theoretical arguments or statements of belief, nor on self-interested statements from the companies. Regarding Chicago's retail conditions, we have two studies with systematic evidence: One is from a University of Illinois at Chicago [research unit](#) that specializes in community economic development. The other, from [NYU's Brennan Center](#), also supports the current attractiveness of locating in Chicago to large retailers.

I agree that higher minimum wages might lead to somewhat higher prices. But this might be a good tradeoff. To find out, again we must draw from careful empirical studies, not general statements, to quantify the effect. My San Francisco study found that a 26% increase in the minimum wage increased restaurant prices by about 2.5%, or 25 cents for an average \$10 menu item. We now know, using Wal-Mart's own data, that if Wal-Mart's hourly pay and benefits scale increased to match those in its industry as a whole, and the



costs were fully passed on to consumers, its prices would increase by only a penny on the dollar. Moreover, profit margins have been increasing in large retail companies, so there is room for pay increases that do not translate entirely into price increases. See ["Wrestling with Wal-Mart: Tradeoffs between Profits, Wages and Prices."](#)

On the issue of turnover costs, no one is arguing that low-wage firms would individually choose to increase their pay and lower turnover, as the savings would not be sufficient. If all firms are required to do so, however, employment can actually increase. In the field of labor economics, this is a standard argument used to understand minimum wage effects. You will find it in every major undergraduate textbook, including those by free-market-oriented economists such as George Borjas and David MacPherson. You will also find an emphasis on turnover issues in understanding labor markets in the [2006 Economic Report of the President](#).

As for applying a standard only to retail, it is likely that other industries will be forced by competition to increase pay as well. To what extent, we don't yet know. Small employers in San Francisco were phased into the minimum wage level in its first two years; I found that they increased wages substantially during the phase-in period.

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**Richard Epstein writes:** Once again, I think that the difficulties here arise as much in the interpretation of the various bits of data as with the data itself. On the various ordinances, I do not believe that the Santa Fe or San Francisco ordinances are focused exclusively on the big boxes, which creates all sorts of distortions between different classes of retailers, and thus has additional adverse effects not found elsewhere. In addition, there is a real question of how the ordinance interacts with the composition of the work force. It is worth remembering that when [Wal-Mart offered low-paying positions](#) in the Chicago suburb of Evergreen Park, 25,000 people showed up for 325 or so jobs.

Clearly the low end of the market is out of whack even under the current labor market structure. It is hard to see how any of these people will do better if they are priced out of the market, even if the firms could scramble to find other individuals at higher wages to fill the more exclusive spots that remain. On the study point, I have obviously had no time to review the studies in Chicago, but that seems to have been true of Mayor Daley, who thought that the threat of the big-box companies to stay out was credible. And it is also important to ask whether these studies take into account the hostile reception that big-box stores get from zoning authorities every time they seek permissions to build. And it is worth noting that the strongest opponents of the big-box ordinance in the city are alderman from low-income districts.

On the Wal-Mart profit figures, the numbers that I have seen differ. The average profit per employee is around \$2,000 per year. That hardly speaks of massive exploitation of workers. Rather it is consistent with the lower prices that it offers to consumers, often from the least advantaged areas, where prices are estimated at around 8% to 13% below



what they would otherwise be. Finally, I am totally puzzled why any labor text would argue that high-wage-low-turnover strategies are only efficient if everyone in town adopts them. The brief explanation that Michael offers here is just not credible.

Why won't the savings be sufficient to induce the change? Indeed any change in position, however small, that improves output should be welcomed, period. There is no prisoner's dilemma game here. A firm that gets higher output from adopting superior strategies should be thrilled if its competitors lag behind. So absent the statute, there should be a really strong incentive to make changes in employment strategies that other firms cannot duplicate. Nor is there any reason in theory to expect non-covered firms to raise wages unless demand for labor increases as the cost increases. It is every bit as likely that non-protected workers will be more numerous and could easily receive lower wages, if they stay in the community at all.

Michael's argument is a huge plea for monopoly wages and collective bargaining, without any explanation as to why employers fiercely resist changes that public officials think are in their interest. And how on his theory do we decide what minimum wage is optimal? Why not \$20, or \$50?

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**Michael Reich writes:** An omitted point is that Wal-Mart and some other companies have had negative effects on retail wages and benefits and on taxpayers. These negative effects create hidden but very real and large costs, especially by increasing the ranks of the uninsured. These effects have been documented in a [series of careful studies](#).

The majority of employers in Santa Fe, San Francisco and, more recently, in Santa Cruz, Calif., have not resisted these policies; the vehemence is coming from a few, mainly Wal-Mart and Target.

In concluding, I want to re-emphasize the importance of carefully-developed empirical evidence to illuminate these controversies, as there are different theories of how competition works in labor markets. Consider the following:

In a standard competitive model, there are no impediments to employee mobility and employers have to pay the competitive wage or lose their entire work force instantaneously. But whenever there are job search costs, or when it takes time for employers and employees to find good matches with each other, or when there are any other impediments to employee mobility, competitive firms face what we call in introductory economics a rising supply of labor schedule. In essence, they face much higher labor costs for every worker when they expand employment.

With these frictions, firms maximize their profits by hiring fewer workers and paying lower wages, relative to the simple competitive textbook model. So a minimum wage mandate can in principle bring about a result closer to the competitive market equilibrium, with both higher pay and higher employment.

How important are these "frictions" in urban and low-wage labor markets? Quite a few studies find that they are the rule, not the exception, even, say, among fast-food restaurants that have many competitors. High turnover and ongoing vacancies are indicators of such frictions. In my San Francisco findings, turnover dropped substantially among firms that were covered by the minimum wage, and did not among firms that were not covered. These considerations are likely to be even more important among very large firms that in effect set local wages by virtue of their sheer size, and not just in retail.

Of course, minimum wages at levels that are set too high will trigger negative effects. (The limits depend in part upon how sensitive consumers are to prices.) But we have moved away from such limits in the past two decades. The national minimum wage in real dollars and relative to average wage is quite low by historical standards. Shouldn't the most productive economy in history be able to pay all of its workers a real living wage?

**What do you think? Share your comments on our [discussion board](#).**

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