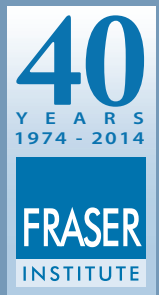


The Economic Effects of Living Wage Laws

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January
2014

Unemployment Line



Contents

Executive Summary / iii

Introduction / 1

1 Background / 3

2 The Economics of Wage Floors / 8

3 Evidence on the Economic Effects of Living Wage Laws / 13

Conclusion / 23

References / 25

About the Author / 31

Acknowledgments / 31

Publishing Information / 32

Supporting the Fraser Institute / 33

Purpose, Funding, and Independence / 34

About the Fraser Institute / 35

Editorial Advisory Board / 36

Executive Summary

For many years, Canadian governments have tried to legislate higher earnings for low-wage workers. With origins at the municipal level, living wage laws are a relatively new policy that gained prominence in American cities starting in the mid-1990s. Currently more than 140 American municipalities have a living wage law. In 2011, the City of New Westminster in British Columbia became the first and only Canadian city to adopt a living wage ordinance. This report reviews the scholarly research on living wage laws from the United States and concludes that the US experience should make us cautious about adopting this policy more widely in Canada.

Living wage laws are similar to minimum wage legislation. Both mandate by law that workers be paid a certain wage rate. However, living wage laws differ by their coverage (covering a much smaller group of workers) and by their amount (requiring a much higher wage). At \$19.62 per hour, New Westminster's living wage is nearly double the provincial minimum wage of \$10.25 and much higher than the rate in American cities. The explicit principle underlying living wages is to ensure full-time workers and their families meet a predetermined living standard promoted by activists.

While the specific definition and coverage of living wage laws vary by US municipality, the ordinance is typically a minimum hourly wage that has to be paid to employees of private businesses that contract with the city to provide public services. Some versions have broader coverage and also apply to employees of businesses that receive financial assistance (subsidies) from the city government.

Although activists claim living wage laws can increase wages with minimal costs, the reality is quite different. Both economic theory and evidence suggest that living wage ordinances, like minimum wage legislation, create distortions in the labour market that have a negative impact on employment. When governments mandate a wage above the prevailing market rate, a typical result is that fewer jobs and hours become available and it is usually the people who are less skilled who are most adversely affected. Indeed, there is a trade-off between the workers who benefit from a higher wage and those who endure the costs due to fewer employment opportunities.

The research looking into the economic effects of living wage laws is not as developed as the minimum wage literature, which spans several decades and over a hundred academic studies. But the conclusion from the best and most rigorously analyzed evidence is that living wage laws have similar unintended consequences. Specifically, evidence shows that employers respond to living wages by cutting back on jobs, hours, and on-the-job training. Those who advocate living wage laws tend to overlook these consequences and instead focus only on the benefits of such policies. The reality is that, while some workers may benefit from a higher wage, their gain comes at the expense of others.

According to research by leading scholars in the field, a 100% increase in the living wage (say going from a minimum wage of \$10 per hour to a living wage of \$20 per hour) reduces employment among low-wage workers by between 12% and 17%. Affected workers therefore lose valuable employment income and the ability to gain new skills and experience that foster upward income mobility.

Research also finds that employers respond to living wages by hiring more qualified workers at the expense of those with fewer skills in order to offset some of the higher wage costs. Living wages therefore reduce the opportunity for less-skilled workers to participate in the labour market. This is a highly perverse outcome since less-skilled workers are presumably among the very people the policy is intended help. And, if employers end up hiring more productive workers who would have been paid a higher wage anyways, it defeats the purpose of adopting living wage laws in the first place.

Importantly, there is a unique feature of living wage laws that mitigates their negative effects upon employment. The government is typically a customer of affected firms and this allows employers more easily to pass on the higher labour costs from the policy rather than scale back on employment (jobs and hours) as they traditionally do in the face of imposed wage floors. Firms affected by minimum wage policies operate in much more competitive environments, which restrains their ability to do the same.

And contrary to what advocates claim, living wage policies are not the answer to the hardships experienced by many impoverished families. The available evidence shows that living wage laws generally do not help the most poverty-ridden families, in part because the overwhelming proportion of those benefitting from living wage laws tend not be poor. One study reviewed in this report found that 72% of those benefitting from living wage laws were not actually poor. Advocates also tend to overstate the overall effect of living wage laws upon the income of workers whose wages are positively affected. While living wage legislation may make them better off in terms of labour market earnings, research shows they will experience a countervailing effect due to reduced eligibility for benefits from government social programs. The net increase in income is therefore less than expected.

In addition to the negative effects upon employment, living wage laws have the potential to inflate city budgets through higher public service costs. Since the research into living wage laws is still in its early stages, many studies have not yet focused their assessments on these costs, which will inevitably be paid for by taxpayers and renters. When evaluating the costs and benefits of any proposed living wage ordinance, it is critical to include these other costs in the analysis.

Introduction

For many years, Canadian governments have tried to legislate higher earnings for low-wage workers. With origins at the municipal level, living wage laws are a relatively new policy initiative that gained prominence in American cities starting in the mid-1990s. In 2011, the City of New Westminster in British Columbia became the first—and is still the only—Canadian city to adopt a living wage ordinance.¹

Living wage laws are similar to minimum wage legislation. Both mandate by law that workers be paid a certain wage rate. However, living wages differ by their coverage (covering a much smaller group of workers)² and by their amount (requiring a much higher wage). At \$19.62 per hour, New Westminster’s living wage is nearly double the provincial minimum wage of \$10.25 and much higher than those in American cities. The explicit principle underlying living wage laws is to ensure that full-time workers and their families meet a predetermined living standard promoted by activists.³

Although activists claim living wage legislation can increase wages with minimal costs, the reality is quite different. Both economic theory and the evidence suggest that living wages, like minimum wages, create distortions in the labour market that have a negative impact upon employment. When governments mandate a wage above the prevailing market rate, a typical result is that fewer jobs and hours become available and it is usually the people with

¹ See City of New Westminster (no date), *Living Wage Employer*. [↗](#) Other local Canadian governments have considered adopting living wage legislation including the Region of Waterloo, the City of Calgary, the City of Ottawa, and the City of Terrace. For more details, see *Globe and Mail*, 2009, Dec. 28 and Massey, 2013, May 9.

² As practised in the United States, living wages typically apply to only employees of companies that do contract work for, or that also receive financial assistance (subsidies) from, municipal governments.

³ In Canada, the living wage is heavily promoted by the following advocacy groups: Canadian Centre for Policy Alternatives, Campaign 2000, The Living Wage for Families Campaign, and several unions including the Hospital Employees Union of British Columbia, Canadian Union of Public Employees, and the Canadian Labour Congress. Living Wage Canada [↗](#) is a website dedicated to promoting living wages in Canada.

the lowest skills who are most adversely affected. Indeed, there is a trade-off between the workers who benefit from a higher wage and those who endure the costs due to fewer employment opportunities.

The main purpose of this report is to review the scholarly research on the economic effects of living wage laws in the United States, where the policy is more widely implemented. While the body of research examining living wage laws is not as developed as the literature on minimum wage legislation, which spans several decades and over a hundred academic studies, the best available evidence on living wages from the United States should make us cautious about adopting this policy more widely in Canada.

The report is organized as follows. Section 1 defines “living wage law” and provides background information on the various types of living wage law as well as what motivates their advocates in the first place. Section 2 briefly summarizes the theory and evidence on the economics of wage floors from the minimum wage literature. Section 3 reviews the evidence on the effects of living wage laws on employment, wages, and poverty. Since research into living wages is embryonic, the section also points out other possible outcomes that have not been extensively explored, like the potential for such laws to inflate the budgets and taxes of city governments.

1 Background

What is a living wage law?

The City of Baltimore, Maryland enacted the first living wage law in the United States in 1994 after labour and religious activists launched a successful campaign requiring city service contractors to pay a living wage. Currently more than 140 American municipalities have living wage laws, including several major US cities like New York, Los Angeles, Chicago, Boston, and San Francisco (Neumark et al., 2012). The City of New Westminster is Canada's only municipality to adopt a living wage ordinance.

A living wage is supposed to ensure that full-time workers and their families meet some predetermined living standard.⁴ As adopted in the United States, living wages are sometimes set so that a full-time worker with a family of four earns more than some measure of poverty (usually the official federal poverty line). In some cases, the living wage calculation is indexed to inflation. Some American municipalities also require employers to provide health care benefits or the equivalent in wages while others mandate paid time off or training for new employees (Cook, 2008: 2).

Table 1 displays the living wage, the prevailing minimum wage, and the percentage difference between the two for select US cities and the City of New Westminster. What is immediately clear is that New Westminster's living wage is much higher than the living wage in US cities as is the percentage increase over the prevailing minimum wage.

It is important to underscore the problems with calculating a living wage in practice, especially in Canada where there is no official poverty line. Inevitably, people will disagree about what is an acceptable living wage and the source of this disagreement stems from what should be included in the calculation. Indeed, different individuals and groups have different views about what items should and should not be covered in living wage calculations.

⁴ A living wage is distinct from municipal "fair wage" policy. Several Canadian jurisdictions have adopted the latter, which is intended to ensure that city contractors "pay their workers union rates, or for non-union workers, the prevailing wages and benefits in their field of employment" (Cook, 2008: 2).

Table 1: Living wage rate per hour in select US cities and New Westminister (British Columbia) and the prevailing minimum wage rate (as of October 2013)

	Prevailing minimum wage (\$)	Living wage (\$)— benefits included)	Living wage (\$)— (benefits excluded)	Difference (%) between minimum wage and living wage (benefits excluded)
New York	7.25	10.00	11.50	58.6%
Los Angeles	8.00	10.91	12.16	52.0%
Chicago	8.25	11.78	11.78	42.8%
Boston	8.00	13.76	13.76	72.0%
San Francisco	10.55	12.43	12.43	17.8%
New Westminister	10.25	19.62	19.62	91.4%

Notes [1] Some American living-wage ordinances allow employers to pay a reduced wage if certain benefits like health care are provided. [2] San Francisco has its own minimum wage separate from the state and federal rate.

Sources: City of Boston, 2013 [↗](#); City of Chicago, 2013 [↗](#); City of Los Angeles, 2013 [↗](#); City of New Westminister, no date [↗](#); City of San Francisco, 2013 [↗](#); Living Wage NYC, 2013 [↗](#); National Conference of State Legislatures, 2013 [↗](#); author's calculations.

Additional complexity will stem from the fact that workers affected by living wage laws will belong to families of different size and composition. A living wage for a single worker with no children will differ from a living wage for a family with two working parents and multiple children. This raises important questions about a one-size-fits-all wage and the feasibility of discriminating based on a worker's family circumstances.

The City of New Westminister's living wage rate comes from the Living Wage for Families Campaign, which uses calculations for Metro Vancouver published by the Canadian Centre for Policy Alternatives (CCPA), an organization that advocates living wage laws (Ivanova and Klein, 2013b). The CCPA's living wage calculation is based on a family of two parents, each working 35 hours per week, with two children ages four and seven.⁵ Joint annual income earned through a living wage is supposed to allow the family to meet a target level of annual expenses after accounting for government transfers and taxes.⁶

For 2013, the CCPA pegs Metro Vancouver's living wage at \$19.62 per hour or \$35,708 annually for each working parent. According to the CCPA, total family income of \$71,416 before government transfers and taxes would

⁵ For details on the CCPA's methodology for calculating living wages, see Richards et al., 2008: 23–34.

⁶ Specifically, income earned at a living wage rate plus government transfers and minus net taxes paid (payroll and income taxes after deductions) is supposed to equal the target level of family expenses.

allow the family to cover annual expenses of \$64,940.⁷ Interestingly, the CCPA claims that its estimate of annual expenses for a family of four is based on a “bare bones budget”. But, on closer examination, the expenses in their budget include money for parental education, a contingency fund, reading materials, recreation, a used vehicle, and entertainment. It is hard to imagine how these expenditures items can be considered part of a “bare bones budget”.

Critically, the CCPA’s annual expense budget is much higher than that of reputable sources estimating a family’s basic needs. For instance, Professor Christopher Sarlo of Nipissing University has rigorously estimated the level of income needed to cover basic needs in different Canadian provinces.⁸ In this context, the basic needs level of income is the amount needed to pay for a nutritious diet, shelter, clothing, personal hygiene, a telephone, public transportation, household insurance, out-of-pocket health and dental-care costs, and many other items. In other words, Sarlo’s basic needs level of income covers more than absolute necessities. Based on Professor Sarlo’s methodology, the basic needs for a couple in British Columbia with two children ages 10 and 12 was approximately \$25,377 in 2010 (Veldhuis et al., 2012). This is approximately 42% of the CCPA’s estimate of annual family expenses (\$60,749)⁹ used in its 2010 living wage calculation.

The CCPA’s estimate also dwarfs Statistics Canada’s after-tax low-income cut off (LICO) for a family of four persons. LICO is “an income threshold at which families are expected to spend 20 percentage points more than the average family on food, shelter, and clothing”. In 2010, the LICO calculation for a family of four living in a densely populated metropolitan area was \$35,469¹⁰—approximately 58% of the CCPA’s “bare bones budget” for the same year.

Which workers are covered by living wage laws?

While the specific definition and coverage of living wage laws vary by US municipality, the ordinance is typically a minimum hourly wage that has to be paid to employees of private businesses that contract with the city to provide public services. In some cases, these “contractor-only” living wage laws apply only to firms with service contracts whose dollar values exceed some pre-defined minimum level. The types of jobs affected by living wage ordinances include security guards, janitors, equipment cleaners, school bus drivers, food service workers, and landscapers.

⁷ See Ivanova and Klein, 2013a, Living Wage Calculation Spreadsheet—May 2013 [XLS] [↗](#)

⁸ For details on Sarlo’s calculations, see Sarlo, 2001, 2013.

⁹ See Richards, Cohen, and Klein, 2010. [PDF] [↗](#)

¹⁰ See Statistics Canada, 2013. [webpage] [↗](#)

Some versions of the laws have broader coverage and apply to employees of businesses that receive financial assistance (subsidies) from the city government—this is usually in addition to the coverage of city contractors. With “business assistance” living wage laws, companies that are recipients of government grants, loans, tax benefits, special bond financing, and other local economic development policies are required to pay their workers the wage set by the living wage ordinance.

In other incarnations, living wage laws can apply to people who work at publicly owned but privately operated facilities (like airports or marinas) and sub-contractors of covered firms. Some American universities have also passed their own living wage policies. In Burnaby, British Columbia, Simon Fraser University is actively campaigning to be the first living wage university in Canada.¹¹

New Westminster’s living wage law applies to all full and part-time employees working for the city as well as employees contracted to perform “physical work” on city-owned premises.¹² According to the city’s website, the living wage does not affect any full or part-time city staff—they already earn more per hour—but it does affect some service contractors with hourly wages below the living wage threshold.

A key takeaway is that living wage laws cover very few workers. Early estimates of “contractor-only” living wages in the United States suggest that the ordinances affect around one percent of workers (Neumark and Wascher, 2008). Even among workers in the lowest 10% of earners, only two to three percent are covered by living wage laws (Holzer, 2008). When assessing the economic impact of living wage laws, their relatively limited scope and coverage can make it difficult to unearth their overall effects. The fact that the laws affect low-wage earners working at companies that sell services to the local government also has important implications for the effects we observe. And then there is the important question as to whether living wage laws actually target poor families in practice. These issues are addressed in later sections.

Motivations of those advocating living wage laws

Beyond the expressed purpose of raising the earnings of low-wage workers, other motivations exist for advocates of living wage ordinances. In a review on living wage policies, American economist Harry Holzer summarizes some of these other motivations (2008: 3; see also Horowitz, 2003); he notes that living wage activists and sponsors may also want to:

¹¹ See Living Wage SFU, 2013. [webpage] [↗](#)

¹² For details of living wage policy, see City of New Westminster, 2010. [webpage] [↗](#)

- ◆ prevent outsourcing of municipal work
- ◆ support union organization
- ◆ limit the use of local government subsidies to large firms
- ◆ mobilize a social movement to fight low wages and inequality
- ◆ protect vulnerable entry-level workers
- ◆ improve employee morale and productivity
- ◆ give symbolic support for some notion of “fair wages”.

Neumark (2004) explores the hypothesis that powerful interest groups like municipal unions gain from living wage laws. Specifically, he notes that “by forcing up the wage for contractor labour, municipal unions reduce or eliminate the incentives of cities to contract out work done by their members, and in doing so increase the bargaining power of these unions and raise wages of their members” (cited in Neumark and Wascher, 2008: 278). Neumark cites “ample indirect evidence” consistent with this hypothesis and particularly points to the fact that municipal unions are strong supporters of campaigns for living wage laws.

It is critical to realize, however, that a reduction in the contracting out of city services would increase costs to city taxpayers since research finds contracting out is a source of cost savings and quality improvements. In an important review of empirical studies on contracting out in public sectors from around the world, Simon Domberger and Stephen Rimmer (1994) concluded that competitive tendering and contracting usually leads to substantial cost savings—in the order of 20%.¹³ Other studies support the finding that privately-provided services are superior to their public counterparts. For example, in two cross-Canada surveys of municipalities, James McDavid (1988) found clear evidence of cost savings due to outsourcing based on productivity differences between the public and private sectors. Domberger et al. (1995) evaluated 61 cleaning contracts in an attempt to determine the effects of outsourcing on costs and quality and found that competitive tendering significantly lowered prices and maintained or enhanced the quality of service. Finally, Levin and Tadelis (2010) analyzed the contracting out of public services in US municipalities and found that private contracting reduced city costs. Specifically, they found cities that privately contract 10% more of their services spend about three percent less per capita.¹⁴

¹³ See also Savas (1982) for international evidence on the effects of contracting out public services and support for private provision.

¹⁴ Levin and Tadelis (2010) estimate that changing one service from city government provision to private contracting is associated with a 0.6% decline in per-capita spending.

2 The Economics of Wage Floors

This section explains the economic theory of government-mandated wage floors and highlights key findings from the empirical research on minimum wages, which is a type of wage floor with a much longer history and a deeper body of research than living wage laws. The findings from the literature on minimum wages inform us of the perils of wage floors and how they distort labour markets. Both living wages and minimum wages mandate the payment of higher wages to some workers than would otherwise be generated in a freely functioning labour market. As this section shows, minimum wage mandates, which affect a much larger group of workers than living wage laws, have many negative unintended consequences.

Theory of wage floors

The standard conclusion from textbook economic theory is that government-legislated wage floors result in lower employment levels (Law, 1999; Gunderson and Riddell, 1998; Neumark and Wascher, 2008). The underlying reason is the supply and demand for labour. Other things equal, employers demand—or are willing to hire—more labour at lower wage rates while workers are willing to supply more of their labour at higher wage rates. The wage rate that ultimately prevails in competitive markets is one that balances the supply and demand for labour.

When governments impose a wage floor (through minimum wage or living wage laws) that is higher than what would prevail in a competitive market, more workers are willing to work than employers are willing to hire. The result is less employment than would otherwise occur as employers find ways to operate with fewer workers and more automation. Of course, the more productive workers who retain their jobs gain through a higher wage rate, but their gain must be measured against the other workers who lose through reductions in employment and, thus, employment income. Importantly, the magnitude of the employment loss is determined by the degree to which the labour demand of employers

responds to changing wages.¹⁵ The bottom line is that a trade-off exists and all effects must be considered when assessing a policy that establishes a wage floor.

Evidence on wage floors from minimum wage research

The negative effects of minimum wage policies upon employment are well-documented in the academic literature. One important study by University of California Professor David Neumark, a leading expert in the area, and William Wascher, comprehensively reviewed the academic literature on minimum wages and employment (Neumark and Wascher, 2007).¹⁶ After looking at more than 100 studies covering 20 countries, Professor Neumark and his co-author found that an overwhelming majority of studies reached the conclusion that minimum wage hikes have a negative impact upon employment.¹⁷

¹⁵ The technical term is the “elasticity of labour demand”. A general rule is that more competitive labour markets—those with routine labour requirements and several competing employers—will have a more responsive labour demand. The fast-food industry is an example of a highly competitive labour market.

¹⁶ Studies looking into the effect of minimum wages on employment typically focus on how wage floors affect employment levels. However, a new study by Meer and West (2013b) argues the effect should appear in the rate of net job growth (jobs created minus jobs destroyed). Meer and West examine data in the United States from 1977 to 2011 and find that a 10% increase in the minimum wage leads to about a one-quarter reduction in the rate of net job growth. They attribute this reduction mainly to decreased job creation by expanding establishments. For an accessible explanation of their study, see Meer and West, 2013a. [webpage] [↗](#)

¹⁷ It should be acknowledged that some minimum wage studies have found no effects or even positive effects on employment but these are a small minority. The most notable studies within this minority are those by economists David Card and Alan Krueger (1994, 1995). The authors studied employment in fast-food restaurants in New Jersey and Pennsylvania and found that employment increased in some areas after a minimum wage hike. However, Card and Krueger’s research has been challenged on theoretical grounds and, more importantly, their empirical work has received serious criticism, calling into question the validity of their results. For example, in a review of Card and Krueger’s findings, Law (1998) explained that Hamermesh (1995) found that the timing of Card and Krueger’s survey approach to collecting data biased their results. In addition, Welch (1995) explained that because Card and Krueger only focused on select fast-food restaurants, they failed to measure the overall impact on employment in the region associated with the minimum wage increase. Perhaps most importantly, a study by David Neumark and William Wascher (2000) in the *American Economic Review* replicated Card and Krueger’s study using actual payroll data and found two important results: (1) Card and Krueger’s survey data suffered from a rather severe measurement error regarding employment changes and (2) instead of positive effects on employment, the authors found large negative employment effects for the same areas studied by Card and Krueger.

In Canada, more than a dozen studies have examined the impact of increases in provincial minimum wages.¹⁸ Based on those findings, a 10% increase in the minimum wage decreases employment for young workers (ages 15–24) by an average of three to six percent (Godin and Veldhuis, 2009). For young workers most affected—those earning between the current minimum wage and the proposed higher wage—the impact is more acute, with job losses of up to 20% (Campolieti et al., 2005).

Minimum wage policies have other unintended consequences. Evidence shows that employers not only respond to a minimum wage floor by decreasing the number of jobs, but they also cut back on hours (Couch and Wittenburg, 2001), provide less on-the-job training and other non-wage benefits (Neumark and Wascher, 2001; Marks, 2011), and give employment priority to their most productive and experienced workers (Neumark and Wascher, 1995).

There is also a growing body of evidence that shows minimum wage increases actually do little to help households in need. One recent study examined increases in the minimum wage across Canadian provinces from 1981 to 2004 and actually found that raising the minimum wage was associated with a four- to six-percent increase in the percentage of families living below Statistics Canada’s low income cut-off (LICO) line (see Sen et al., 2011). In a 2012 study by renowned Canadian minimum-wage researchers, Michele Campolieti, Morley Gunderson, and Byron Lee, the authors analyzed provincial data from 1997 to 2007 and found that raising the minimum wage had no statistically discernible impact on measures of relative poverty including LICO (Campolieti et al., 2012). One important reason for these findings is that the bulk of those working for minimum wage do not actually belong to low-income households. In a 2009 study, researchers used Statistics Canada data to profile minimum-wage earners in Ontario. They found that “over 80% of low-wage earners are not members of poor households” and that “over 75% of poor households do not have a member who is a low-wage earner” (Mascella et al., 2009: 373).¹⁹

Key differences between minimum wages and living wages

The empirical findings from the minimum wage literature show that a wage-floor policy with broad coverage produces an unfavourable trade-off. There are “winners”—those receiving higher wages—but there are “losers”

¹⁸ See Godin and Veldhuis (2009) for a review of this research.

¹⁹ Mascella et al. adopt a relative approach to identifying poor households: a household is considered poor “if its equivalized after-tax income is less than 50% of the median level of income” (2009: 375).

too—those losing employment opportunities. The latter are usually the young and less-skilled workers.²⁰ On balance, the effect of minimum wage legislation on poverty is either negligible or, in some cases, negative. While we would expect wage floors established by living wage laws to result in similar negative employment outcomes, there are key differences between living-wage and minimum-wage legislation.

First, living wage laws cover a much narrower group of workers—typically only those working at firms that do contract work for city governments or that also receive subsidies from the local government. Minimum wages, on the other hand, cover all less-skilled jobs in a jurisdiction.

Second, living wages are much higher than statutory minimum wages. For instance, New Westminster’s living wage in 2013 is set at \$19.62 per hour, which is nearly double British Columbia’s 2013 minimum wage of \$10.25 per hour. The difference between the two policies stems from the explicit principle that living wages be set at a level that ensures full-time workers and their families meet some predetermined living standard promoted by activists.

Third, the demographic profile of living wage workers is different from that of minimum wage workers, who are typically young (between the ages of 15 and 24) and have low education, few skills, and little work experience (Godin and Veldhuis, 2009). Survey evidence from Los Angeles suggests that teenagers constitute a very small share of workers affected by living wage laws (see Fairris et al., 2005).

Finally, living wage laws affect people working in goods-and-services markets very different from markets affected by minimum wage legislation. This is an important consideration. As Holzer notes, in the case of living wages

firms that supply services to government agencies operate in less competitive “product markets” than most other firms, since public agencies face less competition for the services they provide than does the private sector. All else equal, less competitive product markets generate lower elasticities of labour demand, because it is easier for firms to raise prices to cover the higher wages they pay without reducing product demand and employment. (2008: 7-8)

In other words, firms affected by living wages provide services in markets where the local government is a client, which means employers can more easily pass on the higher labour costs emanating from the wage-floor policy.

²⁰ According to Statistics Canada, approximately 60% of workers earning minimum wage in Canada are between the ages of 15 and 24, and of these about 86% live at home with their parents (Veldhuis and Karabegović, 2011). In addition, many of the adults earning minimum wage are supplementing their family income with part-time work during childbearing years and retirement.

Firms affected by minimum wage legislation operate in much more competitive environments (such as fast-food and other retail operations), which restrains their ability to do same.

Despite important differences between the two types of wage-floor policies, both living wage laws and minimum wage legislation mandate that employers pay a wage higher than the prevailing rate set purely by supply and demand. And, because of this similar mandate, many of the negative effects of minimum wage legislation, which have been found in scores of studies over many decades, should in principle also apply to living wage laws.

3 Evidence on the Economic Effects of Living Wage Laws

The research into the effects of living wage laws is not as developed as the literature on minimum wage legislation. Part of the reason is that living wage legislation is a relatively new wage floor policy and it applies to such a small segment of a city's population, which makes it difficult to measure the policy's overall impact. In addition, there are data limitations that pose challenges to measuring the economic impact of living wage laws.²¹

Despite these challenges, there is evidence from scholarly research on the economic effects of living wage laws. All the studies are based on experience in American cities beginning in 1994.²² There is unfortunately no Canadian research to draw from, since the City of New Westminster is Canada's only jurisdiction with a living wage ordinance, which was adopted only very recently, in 2011. In short, the evidence shows that living wage laws, like minimum wage legislation, typically lead to fewer job opportunities for less-skilled workers and, contrary to what advocates claim, do not generally help the poorest families escape poverty. There is also the potential for living wage laws to inflate city budgets through higher costs for public services and to reduce the efficiency of local government.

Types of research

Some of the best and most rigorously analyzed evidence on the effects of living wage laws comes from a series of studies by Professors David Neumark (University of California) and Scott Adams (University of Wisconsin), each

²¹ See Holzer, 2008: 7–11 for a detailed discussion of the characteristics of living wage laws that make it difficult to discern their economic impact.

²² Comprehensive reviews of the research on living wage laws are contained in Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011, Neumark and Wascher, 2008, and Holzer, 2008.

of whom specializes in labour economics.²³ Their studies examine the labour market impact of living wage policies using statistical methods that analyze a combination of American cities, some of which have implemented living wages and others have not. The data they use cover different periods from 1996 to 2002 and come from the Current Population Survey, which provides information on wages, employment, and a variety of other demographic characteristics.²⁴

Neumark and Adams focus their research on the effects on the wages and employment of people in the lowest 10% of the wage or skill distribution and on household poverty rates. After all, the central goal of living wage laws is to raise the earnings of low-wage workers and reduce family poverty. The professors estimate the effect of living wage laws by lumping together all living wage laws without discriminating by type and also by analyzing “contractor-only” and “business assistance” living wage laws separately.

In addition to the studies by Neumark and Adams, other researchers have examined the impact of living wage laws. In one alternative approach, researchers estimate the before-and-after effects of living wage policies in particular US cities using survey data of affected firms. These case studies also focus on the effects on wages and employment and, in addition, consider the impact on hiring practices, employee turnover, absenteeism, work satisfaction, the mix of full- and part-time workers, and other variables of interest.²⁵

A key shortcoming of the case-study approach is the lack of a control group (comparable data from firms unaffected by living wage policies). While this is a major methodological shortcoming, case studies do offer a unique perspective from individually affected firms that the statistical approach used

²³ See Neumark, 2002, 2004; Neumark and Adams, 2003a, 2003b; and Adams and Neumark, 2005a, 2005b. The following discussion excludes the findings from a more recent study led by Professor Neumark (Neumark et al., 2012).

²⁴ One shortcoming of using the Current Population Survey (US Census Bureau and US Bureau of Labor Statistics) is that it is not possible to identify particular workers covered by living wage laws. Typically the statistical analysis is done at the Metropolitan Statistical Area (MSA) level or Primary Metropolitan Statistical Area (PMSA) level. As a result, the estimated impact of living wages is for a broader group that includes uncovered workers. The benefit of the CPS data is that it allows researchers to capture the net effects of living wage laws on low-wage workers and low-income families.

²⁵ There is a separate strand of living-wage research that uses simulations to estimate the potential impact of proposed living wage laws (for example, see Tolley et al., 1999 and Thompson, Courchane, Neumark, Riddiough, and Yezer 2011). This strand of research is excluded from this review because the results do not measure the actual impact of living wage policies. Rather, the results depend on the assumptions and parameters used in the model. But as Thompson et al. (2011) argue, simulation studies have a role to play in thinking about features of living wage laws that have not been implemented elsewhere.

by Neumark and Adams does not.²⁶ The case study approach, however, is ill-equipped to inform us about the broader net effects of living wage laws since the focus is usually on specific establishments and contractor-only living wage laws.

Employment

As economic theory would predict and consistent with the broader research on minimum wage legislation, Professors Neumark and Adams find that living wage laws generally result in less employment for people at the lower end of the wage distribution. When looking at all living wage laws without discriminating by type, Neumark and Adams find that a 100% increase in the living wage (say going from a minimum wage of \$10 per hour to a living wage of \$20 per hour) reduces employment among low-wage workers by 12% and the impact is statistically significant.²⁷ When looking at the separate effects of contractor-only and business-assistance living wage laws, they find a stronger adverse and statistically significant impact from the latter—likely because of the wider coverage. Specifically, a 100% increase in business-assistance living wage laws results in a 17% decline in employment. Indeed, the adverse employment effects of living wage laws seem to become more prominent as the laws cover a larger group.²⁸

Other researchers have also found that living wages adversely affect employment. For instance, University of Kentucky economist Aaron Yelowitz (2005) examined the effects of Santa Fe's living wage laws from January 2003 to June 2005 by comparing unemployment data in Santa Fe to three other municipalities in New Mexico. He found that living wage laws increased Santa Fe's unemployment rate by 3.2 percentage points and decreased the number of hours worked by those who remained employed by an average of 1.6 hours per week.

In a study looking into the effects of Los Angeles' 1997 living wage ordinance, University of California economist David Fairris (2005) found

²⁶ This is not to say that Neumark and Adams' studies do not have shortcomings. While their studies are the most rigorous, other researchers have criticized their work. For detailed responses to these criticisms, please see Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011: 14-26.

²⁷ Neumark and Adams note that the negative employment effect is likely to occur one year after adoption because of the time required to make the necessary administrative or procedural changes for implementing and enforcing a living wage law.

²⁸ Based on the findings from Neumark and Adams, and employment data from Statistics Canada (36,235), the author estimates that a 91.4% increase in New Westminster's living wage (\$19.62 per hour) over the prevailing minimum wage (\$10.25 per hour) would result in an employment reduction between 397 and 563 among low-wage earners.

that 18% of affected firms reported decreases in employment due to the ordinance.²⁹ The decline in employment, including firms that reported no change in employment, was 1.6% of the overall labour force and 2.6% of the affected labour force. The results suggest that a 100% increase in the living wage reduces employment by 10%. Fairris also found that covered firms responded to the ordinance by reducing overtime hours and on-the-job training.³⁰ The reduction in on-the-job-training, a typical result of minimum wage legislation,³¹ is of particular concern since on-the-job training helps workers gain new skills and fosters upward income mobility. Indeed, a more-skilled worker is usually more productive and ultimately better paid.

Mark Brenner's (2005) analysis of the effects of Boston's living wage ordinance between 1998 and 2001 used a survey of city contractors to distinguish between firms that reportedly increased wages because of the living wage mandate and those that did not.³² Brenner found that employment grew more slowly in firms reporting that they raised wages to comply with the living wage ordinance. Specifically, from 1998 to 2001, employment grew 11% in these firms compared to 17% in firms not reporting wage increases. The difference, however, is not statistically significant.³³ Although Brenner views his results as evidence that the living wage ordinance did not reduce employment, the reality is that job growth was slower at firms affected by the living wage ordinance.

Living wage advocates often cite a 2005 study by Michael Reich, Peter Hall, and Ken Jacobs as evidence that such laws do not reduce employment.

²⁹ It should be noted that Fairris (2005) tried to construct a control group, which is rare for a survey-based case study of this nature. The problem, however, is that the control group uses survey data from a sample of establishments collected for a purpose unrelated to examining the impact of the living wage ordinance, which means the control group's survey data are not directly comparable. For a more thorough discussion on the methodological drawbacks of the Fairris study, see Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011: 30-31.

³⁰ However, Fairris (2005) did find evidence that businesses abiding by the living wage ordinance experienced less turnover and absenteeism than unaffected firms. The reduction in turnover is perhaps not surprising since workers who keep their job after a living wage is imposed likely receive higher pay and therefore are less likely to quit.

³¹ For instance, see Neumark and Wascher (2001) who also discuss contrary evidence but still come to the conclusion that minimum wage legislation reduces on-the-job-training.

³² Brenner surveyed 140 firms with city contracts and 105 covered employees. However, the results are only derived from the responses of 66 firms and 97 employees that provided useable information.

³³ Brenner (2005) also found that Boston's living wage ordinance increased the number of full-time workers at both affected and unaffected firms by roughly the same percentage, although the percentage increase was slightly higher at unaffected firms (not in a statistically significant way). There was also some evidence of improved employee morale at affected firms.

Using a survey of covered employers at the San Francisco International Airport between 1999 and 2001, the study purports to find that this living wage law did not have a negative impact on the employment of ground-based non-managerial workers.³⁴ While Reich and colleagues report that employment increased by 15.6% for this group of workers, they do acknowledge this increase is likely attributable to other factors that affected the labour market at the San Francisco airport during the period of analysis, including the opening of a new terminal in 2000, which would require hiring more workers.³⁵

Professors James Buss and Dina Franceschi of Fairfield University found mixed results in their analysis (2003) of trends in the unemployment rate in 40 American cities from 1992 to 2002. Buss and Franceschi compared the unemployment rate for each city to its wider metropolitan area, state, and the national average. They found that some cities with living wage laws experienced improvements in their relative employment performance while others experienced deterioration. In a study that similarly looked at the relative performance of a group of 31 municipalities, Professor Buss and another colleague examined trends in overall employment growth before and after municipalities introduced living wage laws in addition to trends in the unemployment rate after living wage laws had been implemented (Buss and Romeo, 2006). They also found mixed results. While some cities did experience negative labour-market outcomes, they were the minority in the group examined.³⁶

There are some important limitations with the Buss studies. First, they examine the unemployment rate, which is problematic since the unemployment rate also depends on labour market search. In a seminal 1976 study, Jacob Mincer showed that the unemployment rate can go up or down in response to a minimum wage hike. For that reason, labour market economists generally focus on employment. Second, and also problematic, the Buss studies focus on all labour market participants, not less-skilled and low-wage workers, who are presumably the primary target of living wage policies and the most likely to be affected.

Impact on hiring practices

The negative effects of living wages can extend beyond job losses and reduced hours and on-the-job training. In response to being forced to pay all employees more, employers may change their hiring preferences to offset some of the

³⁴ Reich et al. (2005) also find that the living wage law coincided with declines in employee turnover and absenteeism.

³⁵ The author acknowledges the work of Neumark and Adams for pointing out the shortcomings of Brenner, 2005 and Reich et al., 2005.

³⁶ Buss and Romeo's (2006) analysis only considers relative (un)employment trends and does not account for the number of hours worked by employees, which they readily note could have been affected negatively.

increased wage costs by favouring more highly skilled and qualified workers at the expense of workers who are less skilled. Such a substitution especially hurts the most disadvantaged workers, who tend to have the least skill and are the precise people a living wage law is intended to help. In fact, Yelowitz's analysis of Santa Fe's living wage law found that employees with the least skills and education were most negatively affected by the passage of the law. Specifically, Yelowitz (2005) found that workers with less than 13 years of education had their hours reduced by 3.5 per week as opposed to the overall average reduction of 1.6 per week.

Reich, Hall, and Jacobs (2005) explored hiring practices in their study of living wages at the San Francisco International Airport and found that the proportion of employees with lower skills working at the airport declined after the ordinance while the proportion of more highly skilled employees increased. But, the authors note that this could be attributed to a policy that raised the education requirements for new employees and not necessarily the termination of less-skilled workers from their current jobs. Another interesting finding regarding the change in hiring preference is that employers started hiring male workers in some "masculine" low-wage occupations (like security workers). This shift suggests employers favoured workers with the highest productivity potential.

A study by Fairris and Bujanda (2008) examined the impact of Los Angeles' living wage policy on hiring practices. It found that workers hired after the living wage ordinance was implemented had a higher wage prior to joining the firm than those hired before the legislation came into force. Put differently, employers began substituting toward workers who were more highly valued in the labour market. The study also found employers started hiring workers with higher levels of formal training, perhaps because firms wanted workers who already had the skills that would normally be developed through on-the-job training programs.³⁷ Taken together, these findings reiterate the risk that living wage policies will be especially harmful to less-skilled workers. If employers end up hiring more productive workers, who would have been paid a higher wage anyways, it defeats the purpose of implementing a living wage policy in the first place.

Wages

Neumark and Adams find that business-assistance living wage laws can increase the average wage of low-wage workers.³⁸ According to their results, a 100% increase in the living wage with business-assistance coverage may increase

³⁷ Fairris and Bujanda (2008) also estimate that the wage gain from the living wage ordinance to the group of initially employed workers would be dissipated over time through worker replacement and the labour substitution process.

³⁸ Notably, however, Neumark and Adams find that only business-assistance living wage laws produce statistically significant results.

average wages in the lowest 10% of the wage distribution by 6.7%.³⁹ Research using the case study approach also finds that living wages can increase the income of affected workers,⁴⁰ but that is not surprising given that case studies generally only consider the wage of affected workers—not the broader impact on wages. In the aggregate, the wage gain of some workers will be offset by the job loss and earnings of others, though not necessarily on a one-for-one basis.

Putting aside the job loss, the overall increase in income for workers who are positively affected by living wages might be more limited than believed. While living wage laws may make them better off in terms of labour market earnings, there may be a countervailing effect due to reduced eligibility for benefits from government social programs. The implicit marginal tax rate facing low-income families as a result of “claw backs” from other social programs implies a diminished incentive to work, even in light of the higher wage opportunity presented through living wage laws.⁴¹

Poverty

While advocates assume that living wage laws reduce poverty, this may not be the case in practice. For one thing, the wage gains that accrue to workers may not actually belong to families with very low incomes. And the wage gains enjoyed by some might be offset by the job losses and reduced hours endured by others. There is the additional issue of the net effect of living wage laws on household income after account is taken of the reductions in the contribution of government social programs that can result from higher earnings. The overall effect on poverty is an empirical question.

Professors Neumark and Adams are among the few researchers who have explored the impact of living wage laws on household poverty.⁴² According to their findings, only business-assistance living wage laws have a statistically significant impact on the reduction of poverty, whereby a 100% increase in the living wage results in a 12% decrease in the poverty rate of families. As clarified by Neumark and Wascher, “the claim is not that living wages can lift families from well below the poverty line to well above it. But living wages may help nudge families over the poverty line and these average wage

³⁹ Neumark and Adams find that the effect of living wage laws on wages is stronger when neighbouring cities also have living wage laws. This is likely because it is more difficult for businesses to move to areas not covered by a living wage ordinance.

⁴⁰ See Reich et al., 2005; Fairris, 2005; and Brenner, 2005.

⁴¹ See, for example, the discussion in Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011: 41–43.

⁴² In their research on living wage laws, Neumark and Adams estimate the likelihood that a family’s income would fall below the US federal government’s threshold for poverty.

effects may reflect much larger gains for a smaller number of families” (2008: 274). In other words, living wages may help families close to the poverty line but not those dramatically below it.

In their review of living wage laws, Neumark and Wascher explicitly note that “living wages do not appear to help the poorest families, which is not entirely surprising because such families are less likely to have any workers or, if they do, are more likely to have a worker displaced by an increase in the living wage” (2008: 274). They also note that living wage laws may affect poverty differently from minimum wage legislation partly because of the composition of affected workers. Specifically, workers affected by living wage ordinances are more likely to be adults, unlike minimum wage workers, who tend to be youths. In sum, research by Neumark and Adams generally concludes that living wage laws have, at best, a small impact on poverty alleviation and the beneficiaries are not necessarily the most disadvantaged families.

Villanova University Professor Suzanne Clain has also looked into the impact of living wages on poverty. Her research concludes that living wage laws “cannot be touted as an automatic cure-all in the struggle to eradicate poverty ... [since] the magnitude of its effect is not large” (2008: 215). Professor Clain further emphasizes that employers of low-wage workers affected by living wage laws typically provide services to local governments. And this unique arrangement could explain why there might be a mitigating effect on employment reduction and an unexpected effect on poverty reduction. As Clain explains, local governments might “willfully and intentionally commit themselves to maintaining their demand and absorbing the higher costs for such services” (2008: 215). The end result of the law is a redistribution of income from general taxpayers to a narrow group of workers.

Do living wage laws target the poor?

How effective living wage laws are for alleviating poverty depends on the extent to which they actually target impoverished families and result in higher incomes for low-wage workers and their families. Often overlooked is the “claw back” of government benefits and income support for low-wage workers, which offsets a worker’s wage gain and partially negates the potential for reducing poverty through living wage laws. That is, living wage laws that bolster wage earnings may not reduce poverty if they result in a corresponding reduction in income from social programs and welfare benefits. As Matthew Thompson and his colleagues note, the impact of living wages would be particularly weak for initially poor families because they are eligible for more government benefits that would be reduced as earnings increased (Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011: 41).⁴³

⁴³ Advocates of living wage laws who acknowledge the issue of “claw backs” argue that workers gain dignity from being able to provide more of their own family earnings, rather than

Richard Tiokka, Aaron Yelowitz, and Andre Neveu (2005) examined various income supplements and programs targeted at low-income workers and their families in seven US cities to see how higher earnings due to living wage laws actually changed disposable income and poverty among affected workers. Their first important finding was that living wage laws were poorly targeted and did not solely benefit poverty-ridden families. Specifically, 72% of those benefitting from living wage laws did not qualify as poor and more than 40% had incomes twice the poverty line. Of the 28% of those benefitting from living wage laws who were considered poor, only one third were moved above the applicable poverty threshold. Second, Tiokka and his colleagues found that the poverty gap—the amount by which family income falls below the applicable poverty threshold—declined by \$1,700 when they looked at earnings, but only by \$750 based on comprehensive disposal income (which is income after tax and government transfers). In other words, the reduction in the poverty gap was much less pronounced after taxes, partially because of reduced government transfers. The authors conclude that the economic benefits of living wage laws are negligible for very disadvantaged families living in poverty.

Other problems with living wage policies

Research into living wage laws is still embryonic because the policy is relatively new and has been implemented in select jurisdictions in a small number of sectors. Early research has logically focused on the impact on employment, wages, and poverty but further research is needed not only in these areas, but in others as well, if we are to gain a better understanding of the full range of economic effects from living wage policies. After all, living wage laws could result in other negative outcomes such as reduced private profits, increased contracting costs, inflated city budgets, and higher taxes. But these outcomes have not been assessed by researchers in great detail and their extent depends on who actually absorbs the costs of living wage laws.

If costs are borne by employers, then living wages will lead to reduced profits in addition to adverse employment effects. However, if employers pass on the higher labour costs to their “customer”, which in many cases is the local government, this also would not be positive. For starters, the higher costs would lessen the potential savings of, and incentive for, contracting out municipal services. And, the higher cost of some city services will then mean

relying on government benefits (Thompson, Courchane, Neumark, Riddiough, and Yezer, 2011: 42). From the standpoint of economic efficiency, the question then becomes which government policy imposes the least economic damage. Identifying the less efficient between living wage laws and social redistribution programs is beyond the scope of this paper.

reduced spending on other city services and/or increased taxes to finance the extra spending. The latter could result in higher property taxes, which would adversely affect both property values and local development. Importantly, increased property taxes would not only hurt property owners; renters will also be affected because they pay property taxes too through their monthly rental payment.

Unfortunately, there is very limited evidence on the actual impact of living wage ordinances on city budgets and the research into the effect of living wages on private profits and contracting costs is sparse. Brenner (2005) found some evidence of profit reduction in firms affected by Boston's living wage law. Pollin and Luce (1998) suggest that Los Angeles' living wage ordinance raised operating costs for city contractors by between one and two percent and costs to the city by less than one percent (cited in Holzer, 2008: 9). Reich, Hall, and Jacobs (2005: 163) estimate the total costs attributable to living wage policies at the San Francisco International Airport to be \$57.6 million per year or 0.7% of airline revenues. If fully passed on to consumers, they estimate the extra costs would average \$1.42 per airline passenger. Brenner and Luce (2005) conclude from their review that the impact of living wage laws on contracting costs (and competitive bidding) has been "modest".

Finally, living wages could lead to higher enforcement costs for local governments, as they seek to ensure compliance with the policy, adding fiscal pressure on city budgets. There is, however, no research on the impact of living wage laws on enforcement.

Conclusion

This report reviewed the scholarly research on the effects of government-mandated wage floors and living wage laws in particular. The conclusion from the best and most rigorously analyzed evidence is that living wage laws, like other policies that establish wage floors and force employers to pay workers a wage above the market rate, have serious unintended consequences. But, advocates of living wage laws tend to overlook these consequences and instead highlight the benefits of such policies. The reality is that, while some workers may benefit from a higher wage, their gain comes at the expense of others.

Importantly, there is a unique feature of living wage laws that mitigates their negative effects upon employment. The government is typically a customer of affected firms and this allows employers more easily to pass on the higher labour costs from the policy rather than scale back on employment (jobs and hours) as they traditionally do in the face of imposed wage floors. Firms affected by minimum wage policies operate in much more competitive environments, which restrains their ability to do the same.

The evidence nonetheless shows that employers respond to living wage laws much as they do to minimum wage legislation: by cutting back on jobs, hours, and on-the-job-training. Affected workers therefore lose valuable employment income and the ability to gain new skills and experience that facilitate upward income mobility. Employers also respond by hiring more qualified workers at the expense of those who have fewer skills in order to offset some of the higher wage costs. Living wages, therefore, reduce the opportunity for less-skilled workers to participate in the labour market. This is a highly perverse outcome since less-skilled workers are presumably among the very people the policy is intended help.

And contrary to what advocates claim, living wage policies are not the answer to the hardships experienced by many impoverished families. The available evidence shows that living wage policies generally do not help the most poverty-ridden families, in part because the overwhelming proportion of those benefitting from living wage laws tend not be poor. Advocates also tend to overstate the overall income effect of living wage policies for workers whose wages are positively affected. While living wage laws may make them

better off in terms of their labour market earnings, research shows they will experience a countervailing effect due to reduced eligibility for benefits from government social programs.

In addition to the negative employment outcomes associated with living wages, there are other costs like the potential to inflate city budgets and increase municipal taxes. Since the research into living wage laws is still in its early stages, many studies have not yet focused their assessments on these costs, which will inevitably be paid for by taxpayers and renters. When evaluating the costs and benefits of any living wage proposal, it is critical to include these other costs in the analysis.

Taken together, the evidence on living wage laws from the United States should make us cautious about adopting this policy more widely in Canada. Although the City of New Westminster in British Columbia is currently the only Canadian city to adopt a living wage, the risk is that others will follow.

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Acknowledgments

The author thanks Amela Karabegović and Nachum Gabler for their research assistance. He also thanks Dr. David Neumark, Dr. Marc Law, Sean Speer, and Hugh MacIntyre for their peer review of the study and constructive comments. The author takes full responsibility for any remaining errors or omissions.

The author would also like to express gratitude to the Lotte & John Hecht Memorial Foundation for providing financial support for this project. Without their contribution, this project would not have been possible. The views expressed in this study, however, do not necessarily reflect the views of the supporters, trustees, or other staff of the Fraser Institute.

Finally, the author greatly appreciates the assistance and diligence of the Fraser Institute's publications team, whose work improved the quality of the study.

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Date of issue

January 2014

ISBN

978-0-88975-283-2

Citation

Charles Lamman (2014). *The Economic Effects of Living Wage Laws*. Fraser Institute. <<http://www.fraserinstitute.org>>.

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