

An Economic Analysis of the Proposed Santa Monica Living Wage

Prepared by the Empirical Research Group, UCLA

Richard H. Sander, Ph.D.
Professor of Law, UCLA

E. Douglass Williams, Ph.D.
Assistant Professor of Economics
University of the South

Joseph Doherty, M.A.
Associate Director, Empirical Research Group
Department of Political Science, UCLA

September 7, 2000

Table of Contents

<i>Preface and Acknowledgements</i>	<i>2</i>
<i>Chapter One: Introduction and Summary</i>	<i>4</i>
<i>Chapter Two: The Coastal Zone Proposal</i>	<i>7</i>
<i>Chapter Three: The Economics of a Minimum Wage</i>	<i>17</i>
<i>Chapter Four: Sector Effects on Businesses in Santa Monica</i>	<i>22</i>
<i>Chapter Five: Aggregated Economic Estimates for the Coastal Zone Proposal</i>	<i>31</i>
<i>Chapter Six: Beneficiaries of the Higher Wage</i>	<i>39</i>
<i>Chapter Seven: Alternatives</i>	<i>50</i>
<i>Chapter Eight: The Pollin Report</i>	<i>57</i>
<i>Chapter Nine: Conclusion</i>	<i>62</i>
<i>Appendix I: Supplemental Tables for Chapter Two</i>	<i>64</i>
<i>Appendix II: Instrument for Business Survey</i>	<i>69</i>
<i>About the Authors</i>	<i>74</i>

Preface and Acknowledgements

Last fall, representatives of what was to become Santa Monicans for a Living Wage approached us about conducting a study of a “living wage” proposal that the Santa Monica City Council was shortly to commend for the City’s formal consideration. Leaders of this group thought it was important that a systematic, objective evaluation of the Santa Monica proposal be part of the coming public debate. The representatives offered to fund such a study, while giving us complete editorial independence to follow our research where it led. We agreed to proceed under this condition, and our independence has been respected throughout the entire study process.

Unfolding events soon produced two rival “living wage” proposals. The more significant of the two proposals, which we call the Coastal Zone Proposal, would create a minimum wage zone along Santa Monica’s Pacific Coast. The Coastal Zone Proposal is the focus of this study. Santa Monicans for a Living Wage, the rival group, has advanced a more conventional living wage proposal, which is now on the November City ballot. If passed, it would preempt any City ordinance attempting to enact the Coastal Zone Proposal. This study addresses the ballot measure only briefly, in Chapter Seven.

Although we are generally critical of the Coastal Zone Proposal, not all of our findings cut against it. The effects of the Proposal are varied and often complex. We have tried to present our data and our reasoning in sufficient detail so that anyone so inclined can replicate our work and see how we arrived at each of our conclusions.

Two of the principal authors of this report, Richard Sander and Douglass Williams have been working with the City of Los Angeles off and on over the past four years to understand that city’s Living Wage Ordinance. We evaluated and refined the ordinance the City of Los Angeles adopted in April 1997, and one of us has coordinated two evaluation studies of how the ordinance has worked in practice. Partly because few cities have shown L.A.’s commitment to careful evaluation, our reports have been used by dozens of other cities and counties around the country that have adopted or considered “living wage” laws. We hope this study also contributes to the growing national debate over “living wage” laws.

Our work has been aided by several outstanding research associates, who brought to their project well-developed expertise. These include Richard Scheelings, an attorney and labor economist; Michael Sauter, a doctoral candidate in history at UCLA; and Dr. Robert Sockloskie, a statistical methodologist and analyst. Tim Dubois (of the Edward Thomas Companies) and William Delvac (of Latham & Watkins) have assisted us on behalf of Santa Monicans for a Living Wage, and they have been consistently helpful. Tom Larmore (of Harding, Larmore, Kutcher & Kozal) gave us very valuable input on our research and introduced us to other knowledgeable sources. Over a dozen businessmen operating in the Coastal Zone gave generously of their time and trusted us with confidential information about their operations for the case studies that underlie Chapters Four and Five. Professor Scott Bierman of Carleton College read drafts of the report and gave us excellent

and rapid feedback. Advocates of the Coastal Zone Proposal (including leaders of SMART, who initially advanced it) have also been helpful in explaining the goals and theory behind the Proposal.

Study methodology. We had four general goals in this study: first, to understand who would be affected by the Coastal Zone Proposal; second, to understand how businesses would react to the Proposal; third, to estimate the effects of business reactions on the local economy and the workers; and fourth, to explore alternative methods for accomplishing the goals that lie at the heart of the Proposal. Chapter Two addresses the first task, drawing on a range of reliable databases to construct a picture of how many businesses and workers would be affected and the overall magnitude of the transfers involved. Chapters Three and Four take on the second task. To understand business reactions, we examined what available economic theory and research could tell us, closely studied the various economic sectors in the Coastal Zone, and collected data from businesses through nearly a dozen case studies and a systematic survey. (The response rate from affected businesses was about 80%). Chapter Five translates these analyses into some specific estimates of the Coastal Zone Proposal's economic effects after business reactions and other economic consequences are taken into account. Chapter Six takes the "worker impact" estimates from Chapters Two and Five and examines more closely which workers would benefit (in the short- and long-term) from the Proposal. In this analysis, we relied on general demographic databases (the Current Population Survey and the 1990 Census) rather than a direct survey of workers, because we believed that it would be impossible to conduct a scientific, random sample of workers -- certainly not at any reasonable cost. Chapter Seven makes use of similar data to evaluate alternative policies. Chapter Eight assesses Professor Robert Pollin's report on the Coastal Zone.

Inevitably, a study such as this must conform to the schedule of public debate, and the final stages of production of this report were somewhat hurried. With additional time, we would, for example, provide more citations tying our analyses to the work of other economists. To the extent that any errors and inconsistencies remain in this document, we apologize to our readers.

Chapter One: Introduction and Summary

The City of Santa Monica is currently considering a proposal that would mandate a high minimum wage (\$10.69 per hour) and family health benefits for nearly all medium-to-large businesses that operate in a “Coastal Zone” within several blocks of Santa Monica’s coastline. The advocates of what we will call the “Coastal Zone Proposal” view the mandated wages and benefits as a simple matter of economic justice, which would share some of Santa Monica’s remarkable prosperity with many of its lowest-paid workers. Opponents fear the Proposal as an economic Armageddon, a radical intervention in labor-management relations that will drive business from the area, irreparably damage Santa Monica’s business climate, and throw many of the intended beneficiaries out of work.

This study aims to bring economic analysis to bear on the Coastal Zone Proposal. We believe that it is possible to understand and predict many of the effects of the Proposal through a combination of careful use of past economic research with systematic data gathering.

Unlike “living wage” laws, which require government contractors to pay higher wages to the workers on those contracts, the Coastal Zone Proposal is a minimum wage law, applying to all medium and large employers in the Zone. As such, it would be the only minimum wage applied to such a small region anywhere in the United States. In fact, with only one limited exception, no other city has enacted a minimum wage law.

A local minimum wage has the potential to cause economic devastation. Firms that compete directly with other firms unaffected by the wage floor are at a disadvantage; if the competition is sufficiently head-to-head, and the minimum wage substantially raises operating costs, then firms affected by the minimum must either relocate or go out of business.

Most of the businesses in Santa Monica’s Coastal Zone are not in this situation. For a variety of reasons detailed in Chapter Four of this study, many of these firms derive significant benefits by being located along Santa Monica’s beachfront or along the Third Street Promenade. The hotels in the Zone, in particular, are healthy and profitable. If a high, local minimum wage could work anywhere, Santa Monica would be the place.

Nonetheless, our analysis shows that even in Santa Monica’s Coastal Zone, the benefits of a localized minimum wage are dwarfed by its costs. We believe the Coastal Zone Proposal would be unwise, imprudent, and ineffective in achieving many of its supporters’ goals.

Principal Findings

- 1) The Coastal Zone Proposal is a big, expensive, and far-reaching measure. It would initially affect some 53 businesses in Santa Monica. These firms currently employ about 7,000 employees; about four thousand of these would receive wage and/or benefit

increases as a result of the Proposal. If the firms did not make any changes in operating practices, the Proposal would produce wage and benefit increases for workers totaling about \$33 million. (Counting the indirect “ripple” effects on wages from the mandated increases, the total cost rises to \$40 million.) As firms adapted to the new wage regime (or in some cases suspended operations), the medium-term transfer to workers would be substantially smaller -- perhaps closer to \$25-30 million. (By comparison, the total annual cost to businesses and government of the Los Angeles Living Wage Ordinance was less than \$10 million in 1999.) Chapter Two elaborates on these findings.

- 2) Business adaptations to the Coastal Zone minimum wage would vary considerably across sectors. Hotels would absorb most of the cost through decreased profits. Probably at least one of the Zone’s three department stores would close and the others would trim operations. Several restaurants would close and others would either raise prices or trim staff to evade the Ordinance. Medium-sized retailers would modify hiring practices and renegotiate leases. Many of the service businesses (e.g., law firms and consulting firms) would be relatively unaffected. (See Chapters Four and Five)
- 3) The total job loss resulting from the Coastal Zone wage and benefit mandates would probably range between 800 and 1200 jobs. These are conservative estimates; figures based on employer surveys are about twice as high. (See Chapter Five)
- 4) The vast majority of employers in the Coastal Zone, if forced to pay substantially higher wages, would change hiring practices in ways predicted by economic theory: they would use the higher wages to attract and hire more skilled workers. While we think few employers will engage in large-scale replacements of current staff, many will make significant replacements and nearly all will change the character and skill level of their workforces through attrition. Consequently, few of the long-term beneficiaries of the Proposal would be the prototypical “low-wage” worker envisioned by many advocates of the Proposal. (See Chapters Five and Six)
- 5) Even if we ignore the displacement resulting from the elimination of jobs and the hiring of more skilled workers, the wage and benefit increases created by the Proposal would have a minimal effect on poverty in Santa Monica. We estimate that fewer than two hundred of Santa Monica’s working poor work in the Coastal Zone. Under the most optimistic assumptions, the enormous transfers brought about by the Proposal would only lower Santa Monica’s poverty rate from an estimated 9.2% to 8.7%. (See Chapter Six)
- 6) The low-wage workers in the Coastal Zone (that is, those making less than \$10.69 per hour) are not generally from very low-income families. Less than one-sixth of these workers live in households below the poverty line; the median household income of these workers is not far below the median income of all Los Angeles households. Many of the workers live on the Westside, and these are, as best as we can tell, particularly

affluent. Thus, even setting aside the problems of potential unemployment and displacement by higher-skilled workers, the Proposal is an inefficient and generally ineffective method of redistributing income or helping the poor. (See Chapter Six)

- 7) To the extent that the increased business costs mandated by the Coastal Zone Proposal are borne by businesses (rather than workers or consumers), the falling profits of business would gradually be reflected in falling property values. We believe that over a period of years, this effect could lower property values in the Zone by as much as \$300-400 million. These declines would gradually be felt in property tax revenues, which ultimately are likely to fall (relative to levels attained without the Proposal) by \$4-5 million. The City of Santa Monica would absorb approximately 25% of this decline; most of the rest of the loss will fall on the County of Los Angeles, its service beneficiaries, and its taxpayers. The City would incur more direct and short-term losses through declines in the value of such City-owned properties as Santa Monica Pier and the leasehold for the Pacific Shore Hotel. (See Chapter Five)
- 8) The composition of businesses in the Coastal Zone would gradually shift as the effects of the Proposal take hold. The proportion of restaurants would decline (and those that survive will be smaller and usually more expensive); small- and medium-sized retailers would increase. In other words, the makeup of the Zone would gradually shift away from those most affected (and most mobile) and toward those least affected. There would be a limit to such shifts, however, since the character and vitality of the Zone depend largely on its current mix of shops, hotels and restaurants. It is possible, but probably impossible to predict, that the Proposal would decisively shift the spiral of increasing appeal and prosperity in the Zone into a gradual downward spiral. (See Chapter Five)
- 9) We believe that a much better way of helping either low-income residents or low-income workers in Santa Monica is through the development of a City-sponsored wage subsidy, tied to the federal Earned Income Tax Credit. In Chapter Seven, we develop two alternative formulations of this Santa Monica EITC. A wage subsidy of this type would be much better targeted at low-income families; would avoid the harmful employment and business effects of the Coastal Zone Proposal, and would not cost the City significantly more than that Proposal. Moreover, a Santa Monica EITC would serve as a genuine model for the broader community, and could fuel existing efforts to develop a statewide EITC for California. (See Chapter Seven)

Chapter Two: The Coastal Zone Proposal

A. Nature and Goals of the Proposal

For most of the past year, the residents, workers, businesses, and leaders of Santa Monica have been immersed in a debate about a proposed “living wage” ordinance. The Coastal Zone Proposal (not to be confused with its rivals) would require all firms that are (a) located within a Coastal Zone¹ and that (b) employ 50 or more employees to pay all workers a minimum wage of \$10.69 per hour² and provide family health benefits. On September 7th, 1999, the Santa Monica City Council formally directed the City to evaluate the Proposal. The City retained a team of economists, led by Professor Robert Pollin of the University of Massachusetts at Amherst, to do a study. On August 28, 2000, the City released the Pollin report, which is generally sympathetic to the Coastal Zone Proposal. Within a matter of weeks, the City Council is likely to take up both the Coastal Zone Proposal and the efforts to evaluate it.³

Santa Monicans Allied for Responsible Tourism (SMART) developed the Coastal Zone Proposal. SMART representatives with whom we have spoken describe the Proposal as an effort to spread the benefits of Santa Monica’s economic success. They suggest that businesses in the Coastal Zone have benefited from the City’s policies, but that workers have not shared in these benefits.

Many cities around the country have implemented “living wage” laws that set minimum wages for workers on government contracts. There are several rationales for such measures: they represent a way for governments to set a moral example for the private sector; they have some marginal effect on poverty and thus, to that extent, mitigate the irony of government workers receiving government benefits to make ends meet; and they can improve the quality and permanence

¹ The Coastal Zone embraces the portion of Santa Monica within a mile of the Pacific Ocean. The Zone runs from the northwest border of the City down the middle of Fourth Street to Pico Blvd., then east down the middle of Pico to Lincoln Avenue, and south down the middle of Lincoln to the southern border of Santa Monica. Businesses west and south of this border are included in the Zone.

² The Proposal was made by SMART (Santa Monicans Allied for Responsible Tourism), a local activist group, and was intended specifically to target the Santa Monica visitor serving industry. It is estimated that approximately 2.5 million people visit the City annually. One of the reasons SMART chose the number 50 was that the lobby group appears to want to target large companies and chains that own hotels and restaurants in the Zone. Thus according to Stephanie Monroe, who developed the Proposal, “The issue is not the smaller businesses, but the multinational corporations, particularly those that own the hotels.” (See Santa Monica Mirror September 1-7, 1999, page 1)

³ During the early months of 2000, a rival proposal was advanced by Santa Monicans for a Living Wage. This alternative proposal is a more conventional “living wage” measure, mandating a minimum wage for workers on some city contracts. This proposal has been certified as an initiative on the November ballot. We discuss it in Chapter Seven.

of workforces on these contracts. The harmful effects of a higher wage mandate, such as unemployment and displacement, can be entirely avoided if the government absorbs the cost of the higher wage, which governments often do.

The Coastal Zone Proposal is quite different. It is akin to state and federal minimum wage laws, which require nearly all businesses, regardless of whether they have any contractual relationship with the government, to pay employees no less than the mandated wage. The Coastal Zone is distinctive from other minimum wage laws in four ways. First, the scale of the increase (setting a minimum of \$10.69 per hour) goes far beyond any minimum wage law; it mandates nearly doubling the wage that local businesses must pay to workers. Second, the Proposal would require comprehensive family health benefits as well as higher wages (we are not aware of any wage and hour regulation which has mandated that all private businesses provide health benefits). Third, the Proposal limits coverage to a small, targeted zone. Businesses facing each other across Fourth Street in Santa Monica would, under the Proposal, face dramatically different labor costs. Fourth, the Proposal limits coverage to businesses with over fifty employees -- thus creating two very different sets of labor standards within the Coastal Zone.

B. Scale of the Proposal

This section attempts to estimate the scale of the Coastal Zone Proposal by trying to predict the number of businesses and workers affected, the total potential transfer of wealth, and the size of the potential transfers relative to business revenues.

Data and Methodology. We used five different sets of data to estimate the potential effects of the Coastal Zone Proposal. The information in these data generally fell into two categories: industry and labor. There is some overlap between the data sets, which allows some measure of cross-validation among the estimates.

We obtained industry profiles from two sources: InfoUSA, a commercial database vendor that uses state payroll data; and the 1997 Economic Census, a federal government survey containing aggregate data on industries at the city level. The InfoUSA data permitted us to identify, by name and address, the individual Santa Monica businesses that are likely to be affected by the Coastal Zone Proposal, with concomitant industry classification, workforce size and annual sales.⁴ The Economic Census, which provides aggregate information on sales, payroll, workforce size and revenues for businesses at the seven-digit NAICS code level,⁵ allowed us to validate some of the

⁴ The InfoUSA database is extensive. In Santa Monica it lists 711 businesses with 25 or more employees. It is not perfect, however. One of the city's largest employers, Rand Corp., is not in the database. After reviewing the list and using local knowledge, there don't appear to be any other major businesses missing.

⁵ The NAICS code is a re-codification of the SIC codes, and allows for analysis of industries with a high degree of specificity. In Santa Monica, for example, aggregate data on the three department stores within the Coastal Zone are available (NAICS code 452110).

information in the InfoUSA database. It also allowed for cross-city comparisons of industries within Los Angeles County. When combined, these two sources of data provide a robust image of the industries likely to be affected by the Coastal Zone Proposal.

County-wide data on workers were obtained from two sources: the 1990 Public Use Microdata Sample (PUMS) Census data for Los Angeles County (generated by the Census once every ten years); and the Current Population Survey (an annual survey conducted by the Census for the Bureau of Labor Statistics) for the years 1996 to 1999. Both data sources include interviews with random samples of Los Angeles residents that collect data on each respondent’s occupation and industry sector, hours, wages, other sources of income, and source of health benefits. We used these data to estimate the average wage received by industry and job classification, the distribution of hours worked, and the proportion of workers in the industry receiving employer-paid health insurance.

In addition, we used data from our interviews with business managers in Santa Monica, as well as data they provided about their businesses, to refine our estimates. We combined the estimates derived from these five data sets to project the overall cost of providing higher wages and benefits to low-wage workers in Santa Monica.

C. Assumptions and Limitations of this Analysis

The analyses that follow make certain assumptions, because not all of the requisite data are available. For example, industries affected by the Proposal are assumed to have staff structures and pay rates identical to similar industries elsewhere in Los Angeles County. Establishing this as a fact is prohibitively expensive, but one can confirm that this is a reasonable assumption by using the Economic Census. A comparison of the average wage in several major industries (hotels, restaurants, apparel & shoes, department stores) in Santa Monica with the average wage in other areas showed that Santa Monica wages were generally slightly higher than county-wide averages. In comparison to surrounding cities, however, Santa Monica wages were not consistently higher or lower.⁶

⁶We calculated the average hourly wage by dividing the reported payroll for the most recent quarter by the number of employees on March 12, and further dividing by 520 (one-quarter of a 2080 full-time employee’s annual hours). This ignores seasonality and therefore should not be used as a point-estimate of wages; but it is adequate for a comparison of wages across jurisdictions.

Industry	Santa Monica	Culver City	Torrance	LA County
Hotels	\$8.23	\$9.13	\$7.29	\$7.90
Restaurants	\$5.19	\$4.83	\$4.54	\$4.71
Dept. Store	\$8.17	\$6.55	\$7.01	\$6.54

Another fact for which data are unavailable is the number of unionized employees who are employed by firms that would be affected by the Proposal. In lieu of these data, our report simply analyzes all employees in firms large enough to be covered.

Other assumptions are also necessary to clarify ambiguities in the Proposal or in the data. For example, the fifty-employee threshold in the Proposal is ambiguous with respect to full- and part-time employment. Consequently, we assume that each employee in the InfoUSA database is a full-time employee. We must further make an assumption about the number of employees in each firm. InfoUSA provides a range of employees, not an exact figure. We derived a point estimate of the number of employees using the geometric mean of that range.⁷

Another ambiguity in the Coastal Zone Proposal is whether City employees are included, since City Hall is squarely within the Coastal Zone. As the Coastal Zone Proposal does not appear to be aimed at city-related employment, we did not include the City in our study.

At least two limitations deserve mention. In this section, we do not attempt to analyze the loss of jobs or other economic changes that may occur as businesses adjust to the Coastal Zone Proposal. The analysis attempts only to predict the transfer of wealth that would occur if worker wages and benefits were raised to the levels in the Proposal.

In addition, the Proposal is silent on the topic of tipped income in service jobs. We assume that bartenders, restaurant waiters, and their assistants receive tips, and that tipped income would be included in the calculation of a business' liability under the Proposal. Ideally, we would use estimates of tip income from an existing survey of income; but the CPS does not measure tip income. Instead, we have arbitrarily assumed that each waiter and bartender receives tips equivalent to \$5.00 per hour in wages, and that waiter assistants (i.e. busboys) receive \$2.50 per hour in tips. This has the effect of removing waiters and bartenders from the pool of employees who would benefit from the Proposal.⁸

D. Findings

Within the area described by the Coastal Zone Proposal there are 53 companies with fifty or more employees (Table 2.1). There are seven hotels, three major department stores, nineteen

Apparel	\$6.79	\$7.26	\$6.40	\$7.01
---------	--------	--------	--------	--------

⁷ That is, the square root of the product of the high and low end of that range (e.g., the square root of 50*99 is about 70). Empirically, this estimate tends to be more accurate than the midpoint of the range, since businesses cluster more in the lower reaches of most ranges.

⁸ These assumptions are built into the SPSS data and command files we used in this analysis. Anyone interested in obtaining these files can contact Joseph Doherty at doherty@law.ucla.edu.

restaurants, three clothing stores, three law firms, and a variety of businesses providing services. There are approximately 7,041 workers at these companies. Hotel employees comprise about one-fifth of the workforce covered by the Proposal.

We took several steps to arrive at our estimates of the effect of the Coastal Zone Proposal. The first was to estimate the distribution of job classifications in each industry. We used the CPS survey data to capture County-wide patterns and, in general, there are no surprises (see Appendix I, Table A.1). Most retail store personnel are in “sales”, most restaurant workers are in “food preparation and service”, etc. We assume that distribution of jobs within Santa Monica firms is similar to that found in County firms in the same industry.

In the second step we estimated the percentage of employees within each industry and job classification who earned less than \$10.69 per hour (in 1999 dollars). The proportions are generally high. Those employed in personal service jobs (80%) and equipment operators (74%) were the most likely to fall below the threshold. Cleaning and building service workers (72%) and food preparation and service workers (65%) were also very likely to earn less than \$10.69 per hour. The job types likely to earn more than \$10.69 per hour included managerial (18%) and technical (29%).

By industry, the distribution of low-paid workers follows the above pattern. Eating and drinking establishments and hotels have the highest percentage of low-wage workers (67%).⁹ Legal services (16%) and finance, insurance and real estate (31%) have the lowest rates of low-wage employees. (See Appendix I, Tables A.2 to A.5 for details). Note that wages were determined by dividing each CPS respondent’s total wages and salary by the hours reported worked the previous year.¹⁰

Our next step was to examine health benefits. Since the provision of health benefits varies more by industry than by occupation, we examined the proportion of low-wage employees in the relevant industries who receive health benefits through their employer. For purposes of this analysis, only employees earning less than \$10.69 per hour were considered, though it is unclear from the Coastal Zone Proposal whether all employees, regardless of earnings, would be covered by such a provision. We found that low-wage hotel employees were the most likely (50%) to receive employer-provided health insurance. Eating and drinking establishments were the least likely (15%) to provide these benefits to their low-wage employees (see Appendix I, table A.6).

We combined these estimates of wages and health benefits to project the effect of the Coastal Zone Proposal on existing payrolls. This analysis incorporates the percentage of workers earning less than \$10.69, the difference between their wages and the \$10.69 threshold, and the total wages in

⁹ As noted above, estimates of hotel employees do not include tipped income for housekeepers and other services, and thus probably overstate the percentage of workers who would benefit from the Proposal.

¹⁰ Hourly wages were calculated using CPS data on wages and salaries; self-employment and farm income was excluded. Some of these calculations, for still unknown reasons, resulted in hourly wages far below the minimum wage. Rather than remove these workers from the sample, we standardized their wages at \$5.75 per hour.

the industry. We estimate that if the Proposal were implemented County-wide, wage costs in our selected industries across Los Angeles County would increase by 14%. This figure varies dramatically by industry. Wages in eating and drinking establishments would increase 34%, apparel store wages would increase by 22%, and hotel wages would increase by 21%. Most service industry firms would not experience such large increases: finance, insurance and real estate (4%), health services (6%), legal services (2%). (See Appendix I, Table A.7)

Calculating the cost of providing health insurance to workers who earn less than \$10.69 per hour is problematic. We would have preferred to use survey data on benefits paid by employers. Unfortunately, the existing cost of benefits was not in the CPS survey. Instead we used the analysis which Dr. Nady Pourat conducted of businesses covered by the Los Angeles City Living Wage Ordinance. Dr. Pourat found that full family coverage would cost, at a minimum, about \$250 to \$300 per month per employee. Thus \$275 per employee seems a conservative estimate and, if applied county-wide, would result in payroll increases of 8% across the board. This would be highest in the eating and drinking firms (14%) (see Appendix I, Table A.7). It is assumed that all employees would receive this coverage regardless of part-time or full-time status.

We next applied these coverage and cost estimates to the Santa Monica workforce in the Coastal Zone. Starting with our estimates of the number of employees in each covered sector in Santa Monica, we applied countywide wage and health coverage distributions to estimate how many employees would receive wages and health benefits. (Recall that we assumed that only workers earning less than \$10.69 and not currently receiving health benefits would receive them under the Proposal.) We multiplied the relevant number of employees by the average wage needed to bring those employees up to \$10.69, and we used the health cost figures discussed above to estimate the total new health costs for each sector. At this point we are not yet using the information gathered from our interviews with Santa Monica business managers; we are making these projections based solely on readily available data, for purposes of comparison.

We estimate that the Proposal would provide raises to 57% (approximately 3,994) of the employees in affected firms in Santa Monica (Table 2.2). We estimate the wealth transfer due to wages would be approximately \$23.6 million per year within the Coastal Wage Zone. Another 40% (approximately 2,846) of covered employees would receive employer-provided health benefits, at an additional cost of \$9.4 million. The total transfer would be approximately \$33 million. Restaurants and bars would pay the lion's share, with an additional \$8.7 million in wages and \$3.7 million in health benefits. The total cost to the hotels would be about \$6 million, while department stores would face additional costs of \$3.5 million.

Finally, we used these analyses to project how the ratio of payroll-to-sales would change under the Coastal Zone Proposal. Proceeding deductively from our earlier estimates of wages and benefits, we predict that the aggregate payroll of the affected firms will increase from 27% of sales to 34% of sales (Table 2.3). This varies considerably by industry. We predict that firms in the eating and drinking sector will see payroll rise from approximately 28% of sales to 42%, and department stores will see an increase from 11% to 13%.

The preceding assumed that bartenders, waiters and waiter assistants receive hourly tips of \$5.00, \$5.00 and \$2.50 respectively. If we release this assumption then the costs to restaurants increase dramatically. The aggregate transfer of wages and salaries from bars and restaurants to workers would rise from \$8.7 million to \$10.6 million. Health insurance costs would increase, also. We estimate the total transfer from eating and drinking establishments in the Zone to workers would be \$14.7 million if tips are not included in hourly wage calculations.

E. Ripple Effect

As we discuss in Chapter Three, any minimum wage mandate produces a ripple effect among higher-paid workers. If a \$6-per-hour worker and a \$9-per-hour worker at the same establishment both receive mandated wage increases to \$10.69 per hour, the formerly higher paid worker will almost certainly receive some premium to preserve part of the prior wage differential (which in turn will make it necessary for the business manager to raise wages paid to \$11-per-hour workers).

To estimate this ripple effect, we assumed that wage differentials over the range affected by the increase will afterwards average half their former size, and will “ripple” up the pay scale until the increase plays out.¹¹ To make our estimate conservative, we counted only the Coastal Zone Proposal’s mandated wage increase, and not the health benefits, as part of the ripple effect. If we let “W” stand for each worker’s pre-Coastal Zone wage, our assumed “new wage” for each worker making less than \$10.69 was \$5.75 (the California minimum wage) + \$4.94 (the increase for minimum wage workers to bring them to \$10.69) + $1/2 * [W - \$5.75]$ (the amount needed to preserve one-half of the old wage differentials). For each worker making more than \$10.69 but less than \$15.63, the assumed new wage was $W + 1/2 [\$15.63 - W]$. Workers making more than \$15.63 were not assumed to benefit from the ripple effect.

The ripple effect is not small. We estimate that it increases the total wage boost resulting from the Coastal Zone Proposal by 30%, or just over \$7 million. This means that the total cost of the Proposal, as a percentage of existing sales of affected businesses, is close to nine percent.

F. Discussion

Although a number of assumptions are built into our estimates, we believe nonetheless

¹¹ We used the same assumption in our 1997 Los Angeles report, and our research since has suggested that this is a good estimator. Card and Krueger report that in the 1990-91 increase in the minimum wage from \$3.25 to \$3.80, workers in the 5th percentile of hourly wage workers (essentially, those at or very near the minimum) experienced a rise in wages averaging 18% (roughly the amount of the increase) while workers at the 10th percentile (just above the minimum) experienced a 7% increase in wages.

that they represent good ballpark figures. Our assumptions are not skewed in any systematic way, so that a too-generous estimate on one count is offset by a too conservative estimate on another. The data sources overlap, and cross-checking showed that the estimates were consistent across different sources.¹² Our greatest areas of uncertainty are in the coverage of the Proposal itself, such as how the “fifty” employees are counted for the purpose of coming under the Ordinance, and how far up the pay scale the health coverage requirement extends.

Our estimate of the total cost of the Coastal Zone Proposal -- nearly \$40 million -- is an estimate of immediate, short-term effect. Dynamic reactions to the Proposal, such as laying off workers, moving businesses, or unionizing workers, would alter the analysis. The total size of the Coastal Zone economy is quite large; the affected businesses alone have total revenues of around half a billion dollars. An obvious question is how an added cost of the magnitude shown in Table 2.3 affects a particular industry. For example, if profit margins average around 8% of revenues (as a first approximation), the magnitude of the Proposal’s effects is easily ascertainable.

¹² The one exception to this pattern is in the ratio of payroll to revenue. The Economic Census reports for Santa Monica show somewhat higher ratios than were obtained using InfoUSA data. This may mean that the effects shown as a percentage of sales in Table 2.3 are on the low side. The Economic Census (whose figures are more precise) might have been preferred, except that for most business categories it includes too many businesses outside the Coastal Zone to be reliable.

Table 2.1: Number of Businesses in the Zone with 50 or More Employees and Estimated Number of Employees by Industry Sector

Retail	Number of businesses	Estimated number of employees
Dept. Store	3	864
Apparel & Shoes	3	211
Eating & Drinking	19	1969
Other	5	352
Services		
Finance, Insurance, Real Estate	4	652
Business Services	3	777
Hotels & Lodging	7	1233
Other & Personal Services	4	456
Health Services	2	141
Legal Services	3	386
Total	53	7041

Industry	Number of employees getting raises	Number of employees getting health insurance	Cost of raises (\$1,000)	Cost of health insurance (\$1,000)	Total cost (\$1,000)
Retail					
Dept. Store	497	343	2,328	1,132	3,460
Apparel & Shoes	134	98	791	322	1,114
Eating & Drinking	1325	1126	8,734	3,717	12,451
Other	215	161	1,274	531	1,805
Services					
Finance, Insurance, Real Estate	208	125	1,074	413	1,486
Business Services	446	353	2,804	1,163	3,969
Hotels & Lodging	797	399	4,859	1,316	6,174
Other & Personal Services	198	151	1,112	497	1,609
Health Services	50	29	292	96	388
Legal Services	73	62	362	204	566
Total	3994	2846	23,629	9,391	33,020

Source: InfoUSA database.

Table 2.2: Estimated Number of Employees in the Zone Who Would Receive Raises and Health Insurance under the Proposal and Total Costs of These Benefits by Industry Sector

Table 2.3: Estimated Costs of Proposal as Percentage of Sales (not including ripple effect)

Industry	Payroll as percent of sales in 1997	Estimated payroll as percent of sales after Proposal	Difference
Retail			
Dept. Store	11%	13%	2%
Apparel & Shoes	13%	17%	4%
Eating & Drinking	28%	42%	16%
Other	9%	11%	2%
Services			
Finance, Insurance, Real Estate	21%	22%	1%
Business Services	51%	61%	10%
Hotels & Lodging	27%	34%	7%
Other & Personal Services	40%	45%	5%
Health Services	35%	38%	3%
Legal Services	38%	39%	1%
Total	27%	34%	7%

Chapter Three: The Economics of a Minimum Wage

In this chapter, we lay out the general framework that economists use to understand the kind of policy change proposed in Santa Monica. We begin by discussing the minimum wage in the context of a national increase, and then discuss how its effects are likely to operate in a restricted, local setting.

A. General Effects of a Minimum Wage

Economists have widely debated the effects of minimum wages. Most of this debate has focused on one issue: whether increases in the minimum wage cause unemployment. This is an important issue, but there are other effects of minimum wages on which economists share much broader agreement, and we begin with them.

1. Productivity and the “Labor-Labor” Substitution Effect. Economists generally agree that higher-paid workers tend to be more productive workers. If wages go up, whether by an employer’s choice or through regulation, worker productivity is likely to increase, at least to some degree. There are four ways that such an improvement might occur:

- a) If workers receiving the higher pay and better benefits increase work effort and become more productive employees;
- b) If the pay and benefit increases reduce worker turnover, thereby increasing the average level of worker experience;
- c) If higher wages, by making the jobs relatively more attractive to prospective workers, enable employers to hire more skilled and productive workers; or
- d) If, at higher wages, employers require more effort from employees.

Some research has suggested that each of these effects occurs when pay goes up, at least to some degree. However, we believe that only (b) and (c) have really been firmly established to date. Worker turnover does decline when wages go up,¹³ probably for the common-sense reason that when workers get a raise, they have a greater stake in their jobs. Lower turnover helps productivity by reducing the number of inexperienced workers.¹⁴

¹³ Card and Krueger, *Myth and Measurement*, p. 174 (in review of literature).

¹⁴ Lower turnover also helps to persuade employers to invest in training, since it gives employers a greater expectation that training they provide to their workers will not “disappear” quickly through turnover. However, most labor economists believe that employers generally make employees “pay” for some of their training in the form of lower wages. A wage floor can eliminate this possibility, and thus could offset the other incentive for training. It is unclear

It is also well established that employers gradually change the composition of their workforce when wages go up.¹⁵ This, again, is common sense: if a job suddenly pays more, then when employers advertise an opening, they will get more applicants and applicants with stronger “credentials” -- more years of schooling, more relevant experience, and so on. What is hard to measure is the rate at which this “substitution” of new workers for old workers will occur. Much depends on the size of the wage change, the rate of attrition of old workers (recall that turnover has fallen), and the nature of the job. This effect -- known as the “labor-labor substitution effect” in the literature -- may take place gradually, but over the long-term has a significant impact on the human capital makeup of the workforce.¹⁶

It should go without saying that both of these effects tend to be larger in proportion to the size of a wage increase.

2. The “Ripple” Effect of a Minimum Wage Increase. It is also fairly uncontroversial among economists that raising the minimum wage has a “ripple” effect on workers at higher pay levels. To see how the ripple effect operates, consider a hypothetical retail store with the following wage rates:

Stock clerk	\$ 6.00 per hour
Sales clerk	\$ 8.00 per hour
Shift supervisor	\$10.00 per hour
Store manager	\$13.00 per hour

If the minimum wage rises from \$5.75 to \$12.50 (including benefits), then all but the highest paid of these workers will receive pay increases. But at the end of the day, it is unlikely that all of these workers will be earning \$12.50 per hour; the employer will find it necessary to continue some kind of salary differential corresponding to the demands and responsibility of different jobs. The largest salary increase, to the stock clerk, will have a “ripple” effect on the increases received by everyone else, including the store manager. The available research on the size of this “ripple” effect suggests that wage differentials are compressed to about half of their earlier size when minimum wages rise. In our retail scenario, this would produce the following wage rates after the new minimum goes into effect:

Stock clerk	\$12.50 per hour
Sales clerk	\$13.50 per hour

how these two effects “net out” on the training issue.

¹⁵ See, e.g., Daniel S. Hammermesh, *Labor Demand* (Princeton: Princeton University Press, 1993), Chapter 3.

¹⁶ Charles Brown, Curtis Gilroy, and Andrew Kohen, “The Effect of the Minimum Wage on Employment and Unemployment,” 20 *Journal of Economic Literature* 524 (June 1982).

Shift supervisor	\$14.50 per hour
Store manager	\$16.00 per hour

Ripple effects therefore add significantly to the general cost of a living wage or minimum wage law. Our specific estimate of the ripple effect from the Coastal Zone Proposal, explained in Chapter Two, is about \$7 million (nearly a quarter of the total wage impact).

3. Employment Effects of a Minimum Wage. Not long ago, economists almost universally agreed that increases in the minimum wage increase unemployment among low-wage workers. The reasoning is simple: if wages roughly represent the marginal product of workers, then a higher minimum forces employers to pay workers more than this marginal product. Employers would therefore respond by laying off the least productive of their low-wage workers.

This tenet became controversial in the 1990s, largely through the publication of several studies and a book by David Card and Alan Krueger of Princeton, which presented a wide range of empirical studies suggesting that employment rates were fairly stable in the face of small increases in minimum wages. Card and Krueger argued employers in low-wage labor markets have much more power than in other markets, enabling individual employers to act like monopsonists and keep wages artificially low. Card and Krueger also argue that employment losses are mitigated by the “shock” effect of the increase in the minimum wage. According to this idea, firms that face a sudden increase in costs react by looking harder at ways to become more efficient. The problem with the shock theory is that it would also seem to predict a decline in employment, since more efficient firms can do more with fewer resources, including labor.

Card & Krueger’s work has been controversial, but in throwing doubt on the harmful employment effects of a minimum wage, it had a powerful influence in national policy circles and helped pave the way for Congress’s decision in 1996 to increase the minimum wage to its current \$5.25 per hour.¹⁷ The remarkably low levels of unemployment prevailing over the past few years has been seen by many as further evidence that the effects of a higher minimum wage on unemployment are modest indeed.¹⁸

This debate has almost entirely focused on small increases in the minimum wage. The question Card & Krueger pose is whether a 10% or even a 20% increase in the minimum wage need necessarily increase unemployment. The Coastal Zone Proposal, in contrast would, if we include the cost of health benefits, more than double the existing minimum wage in the Zone. Mainstream labor economists, including Card and Krueger, agree that very large increases do increase unemployment substantially. The question is only “how much?”

¹⁷ California has a higher, \$5.75 minimum wage.

¹⁸ Of course, the aggregate unemployment effect is a poor measure of what impact a higher minimum might be having on the much smaller, low-wage market. Available evidence suggests, however, that even here the unemployment effects of the recent increase have been small.

In our view, the most sensible way to answer this question is to look at the specific businesses affected by the wage increase. How much a given business will reduce employment depends on its profit margins, its opportunities to substitute capital for newly-expensive labor, and its ability to eliminate labor-intensive functions. Chapter Four works through these and related issues for the principal economic sectors affected by the Coastal Zone Proposal.

B. The Economics of a “Local Minimum Wage”

The discussion up to this point, and indeed nearly all of the economic literature on the subject, assumes a minimum wage that operates across an entire nation or at least a state. The Coastal Zone Proposal, of course, is quite different: it would regulate only a portion of a medium-sized city in a very large metropolitan region. What difference does this make?

In principle, a local minimum wage that is much higher than the surrounding market should have a dramatic effect on the economy of the regulated area. Low-wage workers throughout the market will compete vigorously for the jobs in the regulated zone, making it particularly appealing and easy for employers to replace existing workers with higher-skill workers. Despite these opportunities for a stronger labor force, however, each business in the regulated zone is likely to calculate how the costs of remaining in the Zone, and paying higher wages, compare to the opportunities for relocation.

The calculus of business relocation involves three principal factors:

First, each business will consider how the higher minimum wage will affect its operating costs. An architectural firm or plumbing supply company may find that costs are only trivially affected by the mandated wage, either because they employ few low-wage workers or because their costs come predominantly from capital and supplies rather than labor. A fast-food restaurant or a garment factory, in contrast, may find that a doubling of the minimum wage increases their operating costs by 40% or 50%.

Second, each business will consider how much it competes with businesses outside the regulated zone. For almost any manufacturing enterprise (like the garment factory), or a non-retail service firm (like a firm that provides services for the film industry), the business product is intended for a general market. The firm competes directly with firms outside the regulated zone. A firm with significantly higher labor costs will lose this contest.

In contrast, some firms have highly localized markets. A gas station at a busy intersection, a roller blade rental shop on the beach, or a taxi stand outside a hotel -- all these depend for their business on the geographic convenience they provide their customers. Such firms are much more likely to have some ability to pass costs on to customers, since for many of their customers alternate locations outside the regulated zone are also poor substitutes.

Third, each business will consider whether it gains some monopolistic rents from its location. A chic restaurant with a well-established clientele has, in effect, built up an investment in its existing location. Some portion of the restaurant's customers come there because it is close by, and many come because past good experiences at the restaurant give them loyalty to it. This restaurant derives from these loyalties some protection against competition, which can, to some extent, allow it to increase prices. The hotels in Santa Monica provide another obvious example; anti-development ordinances limiting the building of new hotels provide existing hotels with some benefits, and decrease the likelihood that they will relocate outside the regulated zone because wages go up.

This discussion should make it clear that these multiple effects will vary from one industry to another, and even within industry sectors. The key, then, is to understand individual business sectors well enough to comprehend and predict specific effects on each sector. Again, these sector analyses underlie Chapter Four, producing the results summarized in Chapter Five.

Despite sector variations, however, the underlying pattern is clear: a local minimum wage increase will tend to have far larger employment effects than a statewide or national minimum wage. Research like Card and Krueger's thus has limited applicability, unless it is applied with a keen awareness of its limitations in this context.

Local minimum wages and the secondary market. In one important sense, the employment effects of a high minimum wage are more benign than those of a national wage increase: workers displaced by a local increase can always seek jobs outside the regulated area. Thus, under the Coastal Zone Proposal, a large unemployment effect (which we do, in fact, foresee) does not mean that all displaced workers remain unemployed. Most of them would eventually be able to find new jobs in the rest of the Los Angeles economy, though most of these new jobs will be even lower paying and otherwise less attractive than the job lost in Santa Monica. We return to this effect in Chapter Five.

Chapter Four: Sector Effects on Businesses in Santa Monica

As the discussion in Chapter Three showed, many of the Coastal Zone Proposal's effects are best understood through studying specific firms. Much of our research concentrated on understanding the key economic sectors operating within the Zone. We surveyed 60% of the businesses in the Zone (including 80% of those most affected), and conducted detailed case studies in about a quarter of the affected firms -- firms that represented a cross section of the businesses that would be heavily affected by the Proposal. In these analyses, we apply basic economic principles to the problems described in Chapter Three to the specific circumstances of the different economic sectors. In Chapter Five, we estimate these magnitudes and summarize estimates for the entire Zone.

Three important themes run through this chapter. First, the costs of the Proposal will be borne by those parties least able to avoid it. Consumers will bear more of the costs to the extent that good alternatives for buying goods and services locally do not exist. Businesses will bear the costs if they cannot readily relocate, substitute capital for labor, substitute high skill labor for low skill labor, restructure to escape the Proposal's grasp or reduce other benefits. Workers as a group will bear more of the costs if capital substitutes for labor exist. Poor, low-skill workers as a subgroup will bear the costs if firms can substitute non-poor, higher skill workers. Finally, landowners will bear the costs if businesses have good location alternatives elsewhere.

Second, the suspicion that Santa Monica businesses realize higher than normal profits does not imply business will proceed unaffected by the Coastal Zone Proposal. It is tempting to think that firms with above-normal profits will simply pay for the costs of the Proposal, with no further consequences for employment. This is a naïve view because businesses as profit maximizers are also cost minimizers. If firms can avoid some of the Ordinance's costs through the means discussed above, they will do so, regardless of their current profit level.

Third, it is unlikely that firms can raise prices sufficiently to pass along all of the increased costs to consumers. This would only be possible if consumers had no ability to substitute to a cheaper alternative. In other words, consumer demand for Santa Monica goods and services would have to be perfectly inelastic. We do not believe that this is the case for any of the business sectors in Santa Monica, so that any price increases will be accompanied by a decline in business volume and a consequent decline in employment. In the discussion below, we refer to a drop in employment brought about by price increases as 'scale' effects. Another reason why price increases are not a magical elixir is that firms may not find that increasing price is a profit maximizing response. We believe this to be true for the hotels and for some of the medium-sized retail stores, as we discuss below. In these cases, businesses will bear the majority of the costs immediately but attempt to pass these costs along to workers and, when businesses do not own their own properties, to property owners.

A. Hotel Industry

General Description of Market for Hotel Services in Santa Monica. The hotel market in Santa Monica is comprised of no fewer than 3 market segments: the “luxury” tier, the “first-class” tier, and the “mid” tier. These tiers are differentiated by the luxuriousness of the accommodations and the capacity to host corporate meetings and conferences. Not surprisingly, prices are highest for the luxury tier and lowest for the mid tier. The average daily room rate is \$350 for the luxury tier, \$250 for the first-class tier and \$150 for the mid tier. The three tiers vary somewhat in the customer base they serve. Both the luxury tier and the first-class tier serve high income tourists and high budget corporate clients, while the mid tier serves relatively more medium income tourists and lower-budget business clients. The luxury tier dominates the corporate meeting/conference customer base.

Locally, Santa Monica hotels compete primarily with other hotels in their tier. For some customer groups, however, competition is across tiers. Luxury tier hotels compete among themselves for the corporate conference clientele, but they also compete with first class hotels for high-income tourists and high-budget corporate clients. Mid tier hotels, in contrast, compete among themselves for middle-income tourists. Thus, the markets for luxury tier hotels and first class hotels overlap slightly, though neither market intersects with mid tier hotels.

Our discussions with owners and managers of Santa Monica hotels suggest that these hotels compete more widely on an LA metro level. The Santa Monica hotels differentiate themselves from the other LA hotels primarily by their proximity to the beach and Santa Monica’s cachet. Santa Monica also offers a unique shopping experience at the Third Street Promenade, fine dining and an active nightlife. This ‘product differentiation’ gives Santa Monica hotels some pricing latitude but the area-wide market they compete in severely restricts this latitude. In other words, any significant increase in hotel prices will lead to significant defections by consumers and a decline in hotel occupancy.

Scale Effects from Price Increases. As we discussed in the last section, some firms may respond to the Ordinance by raising prices, effectively passing some but not all of the price increase along to customers. Any price increase will also be associated with a decrease in demand and a consequent reduction in employment.

Would Santa Monica hotels respond to the Ordinance by increasing prices? We think not for two reasons. First, as we have already discussed, Santa Monica hotels are part of the broader LA metro market. Any attempt to increase prices is likely to lead to a significant defection of customers to LA metro hotels that are unaffected by the Ordinance. Second, because hotel capacity is fixed, hotels have powerful incentives to rent out all of their capacity to pay for it, and increasing prices would create excess capacity. When hotels first enter a market and begin building capacity, they consider the trade-off between the additional revenues generated by greater capacity and the additional costs of building and operating greater capacity. However, once the capacity is built, operation costs are the only additional costs incurred in renting more

rooms. The building costs are fixed once capacity is built and incurred by the hotel regardless of whether available capacity is rented or not. Because the operating costs are small relative to fixed costs compared to other industries, hotels gain less in cost savings than other industries when they raise prices. To understand these incentives, consider a room that rents for \$250 a night. To service one more daily room rental, the extra labor needed is primarily housekeeping services. If renting an additional room requires an hour of housekeeping at \$12.00 an hour (an \$8 wage and \$4 of benefits), then very little is saved by laying off housekeepers, and probably too little is saved to make up for a revenue loss due to the decline in the number of rooms demanded induced by a price increase.

Technically, this argument above along with the numerical example essentially assumes that hotels always operate at a point where short-run (or variable) marginal cost is below marginal revenue. This may not be true when a hotel is operating below full capacity but is always true when the hotel is at full capacity. Since the hotel owners and managers we interviewed very consistently told us that they were at full capacity, we conclude that in the short term the Ordinance will lead to no price increase and no price induced scale effect in the hotel industry.

Because the overall cost of additional capacity has increased, we would expect hotel capacity to decline in the long run as capacity depreciates and is not replaced or is converted to other uses. However, the long run in this case could be 20 to 40 years because of the durable nature of hotel structures.

Labor-Capital Substitution. In our discussion with hotel management, we saw very little leeway for capital-labor substitution (i.e. machines have yet to be invented that can make beds). None of the owners or managers we spoke with suggested ways to us that capital-labor substitution might be accomplished.

Exit Effects. A characteristic of the hotel industry that limits the ability of hotels to avoid the costs of the Ordinance is the immobility of the hotel's capital investment. Hotels cannot move. In the short term, this means that it is unlikely that hotels will shutdown since any excess over operating costs will provide some return on the hotel's capital investment. In the long term, the hotel will remain open if ongoing required investments provide a normal return (i.e., as good or a higher return than is available elsewhere). If the return on ongoing required investments is less than available elsewhere, then the hotel will eventually close in the long term.

In the case of the Santa Monica hotel industry, evidence from our case studies suggests that Santa Monica hotels are making above normal profits, and no hotel owner or manager we spoke with suggested that the proposed minimum wage Ordinance would reduce profits below a normal return. It is important to keep in mind that the present healthy profits of Santa Monica hotels are being experienced in the midst of the strongest economy in nearly 35 years. When the economy eventually does slow down, the hotel profits will not be nearly as healthy. Even so, we would predict that the Santa Monica Living Wage Ordinance would result in no closings in the

short-run and probably none in the long run either.

Labor-Labor Substitution. For the hotels, labor-labor substitution may be the most important effect of the Ordinance. Most managers we spoke to said that they would definitely upgrade the skills of their labor force. They felt that at \$10.69 an hour, they could hire the most experienced workers in the LA metro area. The least educated, least experienced workers -- the ones most likely to be poor and the targets of the Coastal Zone Proposal -- are the likely losers of this labor-labor substitution.

Other Cost Avoidance Behavior. The two or three hotels that are just over the 50-employee threshold would probably find ways to circumvent the Coastal Zone Proposal were it enacted. The most common method will be to subcontract various ancillary services, including room service, laundry service, and valet service. Hotels that cannot get below the threshold will, nonetheless also subcontract services to reduce their exposure to the Ordinance.

Of course, the hotels could avoid the costs imposed by the Ordinance by encouraging their work force to unionize and this appears to be a primary motivation of the Ordinance. Whether hotel owners would choose this course depends on the perceived costs of a unionized workplace. Many firms believe that a unionized workplace increases costs because of reduced flexibility in hiring, firing, and managing workers. For example, union contracts often restrict workers to specific job classifications so that hotel managers have less discretion in moving workers temporarily between jobs to fill vacant positions caused by absenteeism or a shortage of workers in a particular job.

Tax Revenue Effects. An important impact of the Proposal is a lowering of property values for affected hotels. The reasoning is straightforward. The value of any asset is the net present value of income flows from that asset. For hotels and other firms, these income flows are simply economic profits. Because the increase in wage costs imposed by the Proposal will reduce the amount of future income flows, it stands to reason that the property value of the hotel will decline. This is an important consequence for two reasons. First, it represents a wealth transfer from hotel owners and stockholders to the recipients of higher wages. Second, property tax revenue, an important revenue source for cities like Santa Monica and for school districts, will decline. The likelihood of a significant decline in property tax revenues introduces an ironic twist: A policy that is crafted to help poor workers by having the private sector shoulder the burden will likely, in the end, be paid for by taxpayers.

Reprise. To summarize, we believe that in the case of the hotel sector, which is characterized by large, immobile investments, the hotel owners will bear the costs of the Ordinance. In addition, taxpayers, because of a consequent reduction in property values, will also bear the costs of the Ordinance in making up for any shortfall in property tax revenues. We also believe that the hotels will act to avoid these costs by reducing employment and/or outsourcing of jobs and by substituting away from poor, low skill workers to non-poor, high skill workers.

B. Restaurant Industry

General Description of Market for Restaurant Services in Santa Monica. The Market for Restaurant Services in Santa Monica is composed of at least two segments: “upscale” restaurants, and “casual” restaurants. Upscale restaurants offer fine cuisine and, often, an elegant ambiance. Casual restaurants offer more informal dining, and, often, an ambiance that is either “fun” or family oriented.

The customer base for both restaurant segments is made up of tourists, corporate visitors, local business people, and LA metro residents. One owner of an upscale restaurant thought that 1/2 of his customers were local business people and 1/2 were people who lived outside Santa Monica. Compared to casual restaurants, the customer base of upscale restaurants is more likely to be composed of high-income LA metro residents, high-income tourists and high-budget business people -- locals and visitors.

Because upscale dining and casual dining are two very different products in the eyes of consumers, these segments probably do not compete much with each other. Restaurants within each segment, however, compete with each other and also with other restaurants in the LA metro area from the same milieu. This cross-town competition is likely more important in the upscale segment for several reasons. First, the upscale market is smaller overall in the LA metro area, so that fewer good substitutes are available. Second, upscale restaurants are more highly differentiated so that good substitute restaurants are less likely to be available locally. And finally, travel costs from across town are a smaller amount of the total dinner check compared to more moderately priced restaurants so that travel costs play a smaller role in choosing to travel across town to an upscale restaurant.

Scale Effects from Price Increases. The restaurant industry in Santa Monica is situated similarly to the medium-sized retail industry in that tourists and business travelers comprise a substantial part of its customer base. These are, in fact, trapped customers, since dining at other restaurants in the LA metro costs them additional time and travel expense. Like the hotels, restaurants have fixed capacities that have been built to accommodate peak dining periods (i.e. evenings and weekends). When restaurants fix capacity by either building it or leasing it, they take into account the building (or leasing) cost of acquiring additional capacity with the additional revenue to be derived from that additional capacity. Like the hotels, once the capacity is fixed, short-term pricing decisions are driven by the additional operating costs of serving more meals and not the building costs. Unlike the hotels, operating costs for restaurants make up a much larger fraction of total costs, perhaps 60-70%, so that it may be worthwhile for some restaurants to increase prices in the short run in response to the Coastal Zone Proposal. Higher prices will mean fewer customers and lower revenues but the cost savings related to serving fewer customers may well help mitigate the impact of the Ordinance. The price increases will be more important for the upscale segments because their demand is less elastic. (Fewer good

substitutes are available.) Thus, price increases lower their revenue less. Fewer customers require fewer workers to serve them, so some layoffs are likely. These scale effects will be larger in the long-run (5-10 years) as restaurant leases expire and owners adjust capacity downward to reflect the higher operating costs.

The magnitude of this price-induced scale effect and employment reduction will depend on both the increase in operating costs and the elasticity of demand for Santa Monica restaurant services overall.

Labor-Capital Substitution. As with the other industries, we see little leeway for Capital-Labor substitution in the restaurant industry.

Exit Effects. Santa Monica restaurants vary a great deal in their profitability. Some, who own their own property and have successfully established reputations, have above normal profits. Many others, who lease their properties (earning, thus, no economic rents on the land) and have not yet established a brand identity, have normal, if not marginal, profits. Because many restaurants have leases, they are relatively mobile and we would expect those restaurants that are experiencing either normal or below normal returns to leave the industry over time as their leases expire. These are more likely to be the casual restaurants, since they face greater competition and usually derive fewer benefits from a brand identity.

Labor-Labor Substitution. Like the other industries, a mandated wage of \$10.69 would provide restaurants with an opportunity to upgrade their labor force. Again, the population of workers harmed by this labor-labor substitution -- poor, low-skill workers -- is exactly the group that the Proposal aims to help.

Other Cost Avoidance Behavior. As with the other sectors, several restaurants are just over the 50-employee threshold and would likely find ways to reduce their staffing to avoid the Ordinance's mandate. For example, restaurants that now do all of their baking in-house could outsource it. Restaurants may also attempt to avoid the costs of the Ordinance by keeping a portion of the tips. At many restaurants in Santa Monica, owners and managers report that wait staff make in excess of \$20 per hour, with nearly 3/4 of the hourly wage coming from tip income. If restaurants keep 1/3 of tip income, then most of the costs of the Ordinance would be recouped and the wait staff would benefit little from the Ordinance.

Tax Revenue Effects. Like the hotels, the asset value of restaurants will decline if the Proposal is passed because of lower future economic profits due to higher labor costs. The decline in the asset values of restaurants will, in turn, lower property lease rates as restaurants (because of reduced profits) decrease their demand for Santa Monica properties. Because land owners have little opportunity to substitute businesses that are unaffected by the Ordinance (i.e. businesses out of the zone), land owners may in the long run bear much of the brunt of the Ordinance through lower rents for properties. To the extent that lower lease rates appear, the exit effects described above will be moderated.

In any case, because property tax assessment of properties occupied by restaurants depend on lease rates or imputed lease rates in the case where a restaurant owns its land, the Ordinance will result in lower tax revenues from properties occupied by restaurants.

Reprise. To summarize, we believe that the most important effects of the Coastal Zone Proposal on restaurants will be (1) a reduction in employment from restaurants reducing the scale of their operations; (2) a reduction in employment from some restaurants leaving the Santa Monica market; (3) a reduction in employment and/or outsourcing of jobs by those 2 or 3 restaurants near the 50 employee threshold, (4) a significant amount of substitution from poor, low skill workers to non-poor, high skill workers and (5) a reduction in property tax revenue due to lower lease rates, actual and imputed, for restaurants. Any reduction in lease rates, while lowering property tax revenue, will help reduce the number of restaurants that leave Santa Monica.

C. Major Retail

General Description of Market for Major Retail in Santa Monica. Major Retail in Santa Monica is composed of three large department stores – Macy’s, Robinsons May, and Sears. These stores serve both local residents and tourists, and their strategic location near the interstate draws residents from the entire LA metro area to shop.

Scale Effects from Price Increases. Because Major Retail stores in Santa Monica compete for customers in the entire LA metro market, they likely have little leeway for raising prices, lest they lose a substantial number of consumers to other Major Retail stores in the metro area. The policy of at least one of these stores to match advertised prices of competitors in the LA area affirms the view that major retail stores in Santa Monica are part of the larger LA major retail market. We conclude that the volume of major retail trade and employment would change very little from price increases, **assuming** there is not a significant exodus of major retail stores from Santa Monica.

Labor-Capital Substitution. There is little leeway for Capital-Labor substitution in major retail stores.

Exit Effects. We believe that the competitive nature of the Major Retail market in Santa Monica already keeps profits near, if not below, normal levels. We believe that the absence of a financial cushion increases the likelihood that one or more of the major retail stores will leave in the wake of the Ordinance’s implementation.

Labor-Labor Substitution. We would expect those stores that remain open to upgrade their labor force, hiring the best-educated, most experienced workers. Again, the least educated, least experienced workers -- the ones most likely to be poor -- are the likely losers of this labor-labor substitution.

Tax Revenue Effects. As with the other sectors, large retail firms' asset value will decline in response to the lower profits that higher labor costs guarantee. The decline in the asset values of these large retailers will, in turn, lower property lease rates as large retailers (because of reduced profits) decrease their demand for Santa Monica properties. Because property tax assessment of properties occupied by large retail depend on lease rates or imputed lease rates in the case where a large retailer owns its land, the Ordinance will result in lower tax revenues from properties occupied by large retailers.

Reprise. To sum up, we believe that the most important effects of the Coastal Zone Proposal on major retailers will be: (1) a reduction in employment from one or more retailers leaving the Santa Monica market; (2) a significant amount of substitution from poor, low skill workers to non-poor, high skill workers; and (3) a reduction in property tax revenue due to lower lease rates, actual and imputed, for major retailers.

D. Medium-Sized Retail

General Description of Market for Medium-Sized Retail in Santa Monica. The market for medium-sized retail is concentrated on the Third Street Promenade, an outdoor mall in Santa Monica that has become a popular destination for shopping and dining. Medium-sized retail stores that will be affected by the Ordinance include bookstores, clothing stores and stores that sell household goods. These stores serve both tourists and LA metro area residents.

Scale Effects from Price Increases. Compared to large retailers, medium size retail stores have more leeway to raise prices because a larger share of their business is made up of tourists, who are to some extent 'captured' customers. However, because many of their customers are from the metro area and they compete for these customers with other LA metro retailers, Santa Monica retailers risk losing these customers if they raise prices too much. In addition, many of the medium-sized retail firms operate under 'national' prices -- prices that are codified on a web site or a mail order catalog. Because many of these stores use national pricing policies, we would expect very small price effects.

Labor-Capital Substitution. There is little leeway for Capital-Labor substitution in medium-sized retail stores.

Exit Effects. Because the medium-sized retail stores benefit from the high traffic volume on Third Street Promenade, we suspect that these stores are making above normal returns. In our

interviews, managers affirmed this conjecture by indicating to us that their stores exceeded usual corporate expectations. One could wonder why Third Street Promenade property owners, who control the access to this unique property, are unable to capture these above normal profits by increasing lease rates. It may be that the medium retailers, dominated by giants such as the Gap and Abercrombie and Fitch, have sufficient bargaining leverage to split these economic rents (i.e. the above normal profits) with the property owners. What the effect of the Ordinance will be on what appears to be above normal profits of the medium-sized retailers is unclear, but remains crucial to determining whether some medium-sized stores will leave as a result of the Ordinance.

Labor-Labor Substitution. As with major retail establishments, we would expect those stores that remain open to upgrade their labor force, hiring the best-educated, most experienced workers. Again, the working poor are the likely losers of this labor-labor substitution, because they are the least skilled.

Other Cost Avoidance Behavior. Medium-sized retail stores employ many part-time workers, and one way that some stores near the threshold will attempt to avoid the Ordinance is to substitute full-time for part-time workers. As is the case with all of the affected businesses, stores may reduce other benefits to help pay for the higher wage costs (e.g., clothing discounts, retirement benefits, etc.).

Tax Revenue Effects. As with the other sectors, the asset value of medium retail stores will decline if the Ordinance is passed because of lower future economic profits due to higher labor costs. The decline in the asset values of these medium-sized retailers will in turn lower property lease rates as medium-sized retailers (because of reduced profits) decrease their demand for Third Street Promenade properties. Because property tax assessment of properties occupied by medium-sized retailers depend on lease rates, the Ordinance will result in lower tax revenues from properties occupied by medium-sized retailers.

Reprise. To sum up, we believe that the most important effects of the Coastal Zone Proposal on medium retailers will be: (1) substitution from poor, low skill workers to non-poor, high skill workers; and (2) a reduction in property tax revenue due to lower lease rates, actual and imputed, for medium-sized retailers.

Chapter Five: Aggregated Economic Estimates for the Coastal Zone Proposal

To predict the effects of the Ordinance, one would ideally have detailed financial information for each business, as well as information about each business' elasticity of demand (i.e. each firm's sensitivity of product demand to price). As is often the case in real world policy analysis, ideal data are not available. Still, we believe that the economic effects described in Chapter Four stand on a solid theoretical basis and that understanding the magnitude of these effects is of utmost importance to passing judgment on the Coastal Zone Proposal. In this chapter, we attempt to translate the theoretical and conceptual analyses of Chapter Four into concrete estimates of economic, financial, and social effects.

To estimate the concrete effects of the Ordinance, we conducted 11 in-depth, face-to-face interviews with businesses from the different sectors. We also mailed a survey (see Appendix 2) to all the affected businesses, receiving thirty detailed responses by mail and through follow-up phone interviews. In the key sectors where we believe the Coastal Zone Proposal will have a real impact on businesses (hotels, restaurants, and retailers), we gathered information from over 80% of the affected businesses. (Of the sixteen businesses that we believed, a priori, would be unaffected by the Coastal Zone Proposal, eight firms confirmed this in supplemental interviews.) We asked these businesses directly how they would respond to the Ordinance. If someone claimed they would respond a certain way, say close down for example, we then pressed for more information to substantiate the claim. For example, in one restaurant interview where the managing principal said his restaurant would close down, we pressed for more specific information about his current profits, wage costs and what estimates he had made about the cost of the Coastal Zone Proposal. Given the responses, we then made a judgment about the plausibility of the claim.

An obvious criticism of the empirical methodology we employ is that each business has an incentive to exaggerate their reaction to the Proposal. We do not doubt that such a bias exists and that firm claims should be discounted to some degree. This was one of the reasons we conducted face-to-face interviews so that we could cross-examine business principals and develop an independent judgment of their claims. What surprised us, however, was the consistency of the responses within sectors. For example, no hotel claimed it would shut down because of the Ordinance but several restaurants claimed that they would shut down. Similarly, hotel respondents usually did not claim that they would increase prices in response to the Ordinance but all of the restaurants claimed they would increase prices. What came out of our interviews corresponded very closely to what economic theory, as discussed in Chapter Four, would predict. The interviews and surveys, along with the economic theory, enabled us to flesh out these predictions into the estimates reported in this chapter.

Table 5.1: Percent of Firms Responding “Very Likely” or “Somewhat Likely” by Sector

Survey Question No.	Question	Hotels	Restaurants	Medium Retail	Other	All Sectors
1	Increase Prices	43%	100%	0%	20%	61%
2	Reduce Staff	86%	77%	0%	33%	62%
3	Close Down Completely	0%	46%	0%	0%	21%
4	Move	0%	73%	0%	20%	35%
5	Outsource More	86%	55%	33%	33%	56%
6	Restructure	17%	62%	33%	0%	36%
7	Hire More Skilled Workers	100%	77%	67%	20%	71%
8	Require More Effort	86%	67%	67%	20%	63%
9	Cancel Planned Expansions	29%	83%	33%	17%	50%
10	Encourage Unionization	0%	8%	0%	17%	7%
11	Reduce Benefits	43%	46%	67%	17%	41%
12	Replace Tipping with SC	50%	70%	0%	0%	59%
13	No Change	0%	23%	33%	80%	29%
	Total Responses	7	14	3	6	30

A. Employment

Direct effects. As we have discussed earlier, there are five different ways that the proposed minimum wage could affect employment levels in the Coastal Zone:

- It can cause firms to shut down, producing layoffs of all current workers;
- It can cause firms to raise prices to pay part of the cost of higher wages, leading to a decline in sales and partial layoffs;
- It can cause firms to redesign their operations, so as to get their workforces below the 50 person limit of the Ordinance;
- It can cause firms to economize on workforce size by shifting some functions from lower-skill to higher-skill labor, or substituting machines for labor;
- It can cause firms to subcontract work to firms not covered by the Ordinance, possibly shifting some work outside of the current Zone.

Predicting whether any specific firm would adopt some or all of these methods to adapt to the higher minimum wage is, of course, speculative. But our research on the various sectors of the Coastal Zone economy shows clear patterns in how businesses think they will respond, and those patterns are generally corroborated by other research and economic theory. Table 5.2, on page 36, summarizes the patterns of response we think are most likely within each sector. While any given prediction might prove incorrect, the estimates in the aggregate are more powerful and reliable. Below, we summarize our predictions for each sector and then summarize the aggregate predictions.

Hotels. Because we do not expect hotels to increase prices or relocate, we think the employment losses in the hotel sector will be small. We do however believe that there will be some employment losses as hotels reduce staff by requiring more of existing workers (86% of surveyed hotels claimed they would require more effort of workers) and by hiring workers that are more productive. We estimate conservatively that employment in the hotel sector will decline by 2-5%. This estimate is admittedly speculative but seems safe to us, given that the new workforce composition after the effects of labor-labor substitution should be significantly more productive. Assuming a 2-5% decline in employment implies a loss in the hotel sector of 24-61 jobs. We also note that the hotels we interviewed self-reported they would lay off in excess of 130 workers, so that our estimate considerably discounts the claims of hotels we interviewed.

Department Stores. Based on our interviews, we believe that there is a significant likelihood of at least one department store and maybe two closing as result of the Ordinance. This judgment is based on a discussion with a store manager of his operating numbers and the

impact of the ordinance on wage costs and operating profits. Given the competitive environment this store operates in, we do not believe that the store has much latitude to raise prices. A corporate executive of this store confirmed our independent judgment. He told us “that the store would likely close sometime” in the next five years, were the Ordinance to pass. We think it possible that one of the other two stores might be sufficiently affected that they too decide to exit. One or two out of the three stores represents somewhere between 30-50% of the total employment in the large retail sector or 259-342 jobs.

Restaurants. Our interviews with restaurant owners indicated that the restaurant sector will be one of the hardest hit sectors because a large proportion of their wait staff are at the current minimum wage, so that the wage costs for these employees would double. Based on our discussion with restaurant owners of their current financial situation and the financial impact of the Ordinance, we believe that several closures are likely, representing perhaps 15-30% of total employment. If a tip credit is allowed, job loss will be in the lower part of the range. Again, this estimate is admittedly speculative. Still, 73% of restaurants in our surveys reported that they would move or shut down if the Ordinance were passed. So again, our estimate amounts to a discount of about 50% of what restaurants actually reported they would do.

We add three caveats about employment losses for restaurants. First, they will be much less if tipped employees are excluded from coverage by the Ordinance. Second, they will be somewhat less if restaurants eliminate tipping practices and instead collect and keep a service charge on each check. Finally, they will be much less if the reduction in restaurant operating income is absorbed by lower lease rates, which, as we discussed earlier, is a real possibility. However, to the extent that lower lease rates mitigate employment losses, property tax revenue will decline. Therefore, the question is not whether the Ordinance will have costly effects, but who will bear the costs? Will it be workers, taxpayers, property owners, or restaurants? We think it most likely that workers, property owners, and taxpayers will be hit hardest. Restaurants will primarily bear transitional costs of relocation and adjustment; if they face substantial long-term costs, they will simply leave the Coastal Zone.

Medium-Sized Retail. As we have discussed earlier, our judgment is that medium-sized retail firms are quite healthy overall. Still, most of their workforce would be affected by the Coastal Zone Proposal and it would not be surprising were at least one store now making normal or above normal profits to become a marginal performer under the Ordinance. Because many of these stores have little leeway to increase prices, we predict that possibly one or two of the smaller medium-sized retailers might leave because of the Ordinance. The smaller stores are more vulnerable because these stores probably have less bargaining power in negotiating lease rates. It would then stand to reason that for these smaller stores property owners are able to capture any potential above normal profits by raising lease rates. We predict that perhaps one or two of these stores might leave if the Ordinance were to pass, reducing employment by 10-15% or 56-84 jobs.

Pacific Park on the Santa Monica Pier. The arcades, food shops, and rides on the Santa

Monica Pier (operated by Pacific Park) are a special case worth some discussion. The Park is a heavily seasonal operation, running on much more extended hours and with a much larger staff during the summer. Many of the summer and weekend employees of the Park are teenagers actively recruited from local high schools and paid the minimum wage in exchange for access to the “scene” at Santa Monica Pier and the development of job skills. The Coastal Zone Proposal would dramatically increase costs at the Park and would require a fundamentally different business and hiring strategy. Of all the firms within the Zone, this is the clearest example of a business that would both reduce employment sharply and engage in large-scale upgrading of its labor force. Despite these changes, the Proposal would substantially increase the Park’s operating costs. Since the Park’s owners have made recent and large capital investments (e.g., new rides), it is unlikely that they will shut the Park down without trying a variety of changes (new workforce strategy, changed pricing strategy, and renegotiation of the City lease, for starters). The long-term viability of the Park would depend on the success of those changes.

Overall effect. We predict that overall the Coastal Zone Proposal would bring the loss of approximately one thousand jobs in the Coastal Zone -- most of them formerly low-wage jobs affected by the new minimum. This number will be somewhat less if property values, and thus business’ fixed costs, fall significantly as we suggest in Chapter Four. But as we discuss in the next section, a fall in property values large enough to reduce these employment effects is wrought with problems of its own -- namely, a decline in property tax revenue over time. But even ignoring the possible offsetting effects of a decline in lease rates, the loss of one thousand jobs is a more modest impact than one might predict for such a dramatic regulation; in many other contexts, a local minimum wage that more than doubles the minimum wage prevailing in surrounding communities could lead to a virtual wipeout of local business. The Coastal Zone is buffered by the fact that most of its economy is built around the unique and very attractive environment of Santa Monica. Nonetheless, the loss of one thousand jobs is enormously important to the holders of those jobs, and, by itself, arguably negates the likely benefits of the Proposal.

Table 5.2: Significance of Likely Job Loss

Sector (and number of firms likely to be affected)	Current Employment in Firms with 50 or more employees	Significance of likely job loss due to:					Subcontracting	Estimated proportionate job impact	Estimated job loss
		Closures	Layoffs driven by higher prices	Layoffs aimed at avoiding coverage	Labor reductions due to higher-skill, more capital-intensive operations				
Hotels (7)	1233	Unlikely	Unlikely	Possible at 1 or 2 small hotels	Very modest	Likely	2-5%	24-61 jobs	
Department stores (3)	864	One closure likely, others possible	Unlikely	Unlikely	Likely	Likely	30-50%	259-432 jobs	
Restaurants (18)	1736	Several closures likely	Modest effect	Likely	Likely	Likely, in the form of more use of prepared foods	15-30%**	260-520 jobs	
Medium-sized retail (8)	563	Possibly one or two	Unlikely	Likely	Modest	Unlikely	10-15%	56-84 jobs	
Santa Monica Pier*(1)	233	Unlikely in short term	Likely	Unlikely, unless subsidiary operations are formed	Likely	Likely	25%	58 jobs	
Other firms (16)	2412	Unknown	Unlikely	Unlikely	Unlikely	Unlikely	Probably negligible		
Total	7041						12-16%	845-1127 jobs	

*Note that the Santa Monica Pier is treated as an eating/drinking establishment in Chapter Two.

**The lower-bound estimate would apply if tipped income is counted towards the \$10.69 minimum.

Indirect effects. Workers who lose their jobs in the Coastal Zone would, in most cases, seek new employment elsewhere in Los Angeles. We will call this non-Coastal Zone labor market the “secondary” market. Even in a period of relatively low unemployment, as we enjoy today, the supply of jobs in the secondary market is, of course, limited. The former Coastal Zone employees compete with current job holders, and other job seekers, for these limited jobs. The predicted economic effect of this competition is twofold. Wages in the secondary market will fall, as employers find it easier to fill positions and replace lost workers. At the lower available wages, some job seekers will not accept positions in the secondary market, preferring to rely on

other family members for support, seeking further training, or waiting for new job opportunities.

The wage decline from a thousand new entrants into the secondary market can be significant, within the specific workplaces the job-hunters seek out. Given the vastness of the Los Angeles labor market, however, these wage effects would not be detectable in general economic statistics for the region. More concrete are the long-term job losses of those who are unable to find new jobs in the secondary market, or who withdraw from the labor market because of the lower wages. Based on a similar economic analysis we conducted for the City of Los Angeles,¹⁹ we can roughly estimate that a third of the job losses in the Coastal Zone (that is, probably over 300 jobs) will remain as long-term job losses, after all secondary market searches have played themselves out.

B. Property Values and Property Tax Revenues

As we have seen, the massive transfer effects of the Coastal Zone Proposal will cause some businesses to shut down, some to raise prices, some to reduce employment, and others to make other adjustments, all aimed at minimizing disruptions to their business. If a business cannot do any of these things, or to the (very large) extent that adjustments do not offset the costs of the Proposal, firms will end up absorbing the costs -- that is, their profits will go down.

One effect of falling profits would be some damage to the image of the Coastal Zone as an appealing place to do business -- the so-called "Business Climate" effect. (More on this in a moment.) A much larger effect of falling profits, however, is upon property values. Consider a hotel that sits on its own land, and has net operating profits of \$5 million per year. The value of the hotel is essentially the capitalized value of its expected profit stream. Put simply, investors will judge what they are willing to pay for such a hotel based on how much they think the hotel will earn in the future. In a stable or growing business climate, a \$5 million annual profit would translate into something like a \$70 million value. If the Coastal Zone ends up (after adjustments are made) costing the hotel an additional \$2 million per year, then profits fall to \$3 million and the hotel's market value falls to \$42 million.

The story varies slightly if a business leases the land on which it operates. Suppose that a restaurant with a five-year lease sees its profits fall from \$700,000 to \$200,000. The restaurant may decide that this profit is not sufficient recompense for its investment, and it may move, or cut operations, or renegotiate its lease. Regardless the choice made, the demand for the property on which the restaurant sits will fall, unless other businesses who will not face similar losses are waiting to jump onto the space.²⁰

¹⁹ Williams and Sander, *An Empirical Analysis of the Proposed Los Angeles Living Wage Ordinance*, pp. 34-40 (1997). In this analysis, we assume that the elasticity of labor demand in the "uncovered" market is .5, and the elasticity of labor supply is .2.

²⁰ This might happen to some extent in the Coastal Zone, since the Third Street Promenade has experienced rising interest from high-end retailers. But it seems unlikely to offset these very large effects on the operating

To the extent that businesses in the Coastal Zone end up bearing the costs of the Proposal through lower profits, then, property values will fall. The effect is not trivial. We estimated in Chapter Two that the wage, benefit, and ripple effects costs of the Coastal Zone Proposal would, in the short-term, be over \$40 million. To estimate roughly, perhaps one-third of this might be offset through employment losses, business closures, and higher prices. This would leave a \$27 million effect on the operating incomes of businesses in the Zone. Capitalized, this implies a \$300-400 million hit to property values in the Zone.²¹

A \$300-\$400 million drop in property values has two dramatic effects on Santa Monica. First, it mitigates the Business Climate effect. New businesses that might have avoided the Coastal Zone's high wages are nonetheless attracted by much lower real estate prices in the Zone. If a business can operate in the Zone without falling under its minimum wage and benefit provisions, and if the Coastal Zone retains its current cachet as a fashionable, exciting, and busy place, then that business will consider the Zone seriously. One would expect to see, over time, businesses that are not covered by the Proposal replace those businesses that are.

The second dramatic effect is upon property tax collections. A \$300-400 million drop in property values will affect some assessed valuations immediately. For many others, reassessment will occur only after the business changes hands (due to Proposition 13). But the long-term outcome seems clear. Property tax revenues will fall \$4-5 million below the levels that would otherwise exist. Since at least 25% of property tax revenues come back to the City of Santa Monica, City revenues from this source will ultimately fall by \$1 million or more. The rest of the property tax loss affects the County of Los Angeles, its services (and service recipients), and taxpayers throughout the county.

It should not surprise us very much that much of the ultimate cost of the Coastal Zone Proposal falls on landowners. Since the Proposal ties increased burdens to businesses on the land, and the land is (of course) completely immobile, landowners would absorb the greatest hit. But since landowners are a major source of revenue for Santa Monica through the property tax, the effects are ultimately felt more widely.

profits of existing businesses.

²¹ In our discussions with business operators, senior assessors with the County of Los Angeles, and hotel industry analysts, there was general agreement that the ratio of business value to annual net operating income, but businesses in the Coastal Zone, was in a range of 10 to 14, with the higher figure applying to businesses with lower risk.

Chapter Six: Beneficiaries of the Higher Wage

Backers of the Coastal Zone Proposal believe it would help many of the poorest workers in Los Angeles, reduce poverty, and redistribute income. Some backers are particularly eager to help the poor living in Santa Monica. We believe that the higher wages mandated by the Proposal would produce some of these benefits, but not to a very great extent. In this chapter, we work through a series of analyses aimed at assessing who will benefit from the higher wages.

A. The Minimum Wage as an Anti-Poverty Tool

It has long been recognized that a minimum wage is a blunt instrument for attacking poverty. Millions of workers in the United States have jobs at or close to the minimum wage, but many of them are teenagers and most are not their family's primary wage earner. Over 40% of workers who make less than \$7.50 per hour live in households or families with incomes above the national median.²² Thus, most of the higher income that comes from the periodic national increases in the minimum wage does not go to the families below the poverty line, or even to families in the bottom fifth of the income distribution.

Do these generalizations apply to Santa Monica? Assessing the Coastal Zone Proposal's impact on poverty is a more complicated question. In many ways, the Proposal performs more poorly than a national minimum wage in focusing on the working poor. Compared to the 10-20% increase in minimum wages that Congress periodically enacts, the Coastal Zone Proposal contemplates an increase of about 100%, catching within its sweep a much broader range of workers. Workers at the minimum wage would of course receive the largest increases, but even workers earning \$9.50 per hour would receive substantially higher pay and benefits. And while close to a third of Los Angeles workers who earn the California minimum wage are part of households or families in the bottom fifth of the income distribution,²³ the same is true for only 13% of workers earning less than \$10.69. (See Table 6.1)

On the other hand, one could argue that the Coastal Zone Proposal targets workers who are particularly likely to be part of the "working poor". Almost none of the affected workers in the Zone work at fast food restaurants (the stereotypical province of teenage minimum wage workers), while a substantial number work in jobs that are often thought to be held predominantly by the "working poor" (e.g., hotel maids).²⁴

²² Williams and Sander, 1997 study, p. 44, based on 1996 CPS data.

²³ *Id.*

²⁴ How much this is really true is open to question. Clearly very many of the low-wage jobs affected by the proposal are held either by well-educated single people (who predominate, for example, in waiter and waitress jobs) or by classic "secondary" workers (e.g., department store sales clerks who often are earning a second and third

Empirical data can help us to resolve this question. As our data in Chapter Two suggests, we have a good idea of which workers the Coastal Zone Proposal would affect, in terms of industries, occupations, and wages. We can use Current Population Survey (CPS) data, which has detailed information on the economic circumstances of workers, to estimate the current household incomes of workers affected by the Proposal.²⁵ Specifically, we used the CPS data to determine the distribution of household incomes of all workers earning less than \$10.69 per hour in industries that correspond to those that would fall within the Proposal's reach.²⁶ The results of this analysis are presented in Table 6.1 and in the middle column of Table 6.2.

Table 6.1 reveals that only one-fourth of the low-wage workers in the CPS sample have household incomes under \$20,000. Nearly half have incomes higher than that of the median Los Angeles household. Table 6.2 reveals that only 15% of these workers come from poverty households. In other words, the households of these workers are not appreciably different from the general distribution of all Los Angeles households. By this measure, the Proposal is not much better targeted than a program which gives cash bonuses to randomly selected households in Los Angeles County.

The limitation of this method is that, in relying on CPS data, we are treating Los Angeles County as a whole as a proxy for the Coastal Zone. In other words, in computing the household incomes of department store clerks, we used CPS data on clerks working throughout the County, rather than just those working in Santa Monica. On balance, we believe that this method probably understates the actual income levels of Coastal Zone workers. Some employers, such as the luxury hotels in Santa Monica, have pay levels that probably exceed Los Angeles averages. Santa Monica restaurants and retailers probably have a larger proportion of affluent teenagers, aspiring actors, or workers with affluent spouses than do similar establishments in Los Angeles generally. Our analysis in the next section, as summarized in Table 6.2, provides further support for this conclusion.

income for their household). Moreover, a significant number of the hotel maids in the zone earn more than \$20,000 per year.

²⁵ For further methodological information on the CPS, see Chapter Two.

²⁶ As in our Chapter Two analyses, we used CPS data for the past four years (March 1996 through March 1999) to increase our sample size.

Table 6.1: Comparison of Selected Workers by Income Decile

Based on all CPS households in Los Angeles County (N=7,396)		% of workers in selected industries, earning less than \$10.69 per hour, who have household incomes within each category (N=458)
Household income, by decile	Range in Household Incomes	
0-10 th percentile	Under \$8,820	2.8%
10-20 th percentile	\$8,821 to \$13,684	10.0%
20-30 th percentile	\$13,685 to \$19,125	12.2%
30-40 th percentile	\$19,162 to \$25,344	16.2%
40-50 th percentile	\$25,357 to \$32,998	14.6%
50-60 th percentile	\$33,000 to \$41,964	14.4%
60-70 th percentile	\$42,000 to \$52,862	13.1%
70-80 th percentile	\$52,903 to \$70,065	8.5%
80-90 th percentile	\$70,100 to \$98,780	4.8%
90-100 th percentile	\$98,834 to \$688,872	3.3%

Source: 1996-1999 Current Population Survey for Los Angeles County, pooled file, Bureau of Labor Statistics.

B. Helping the Poor in Santa Monica

While many of the proponents of the Coastal Zone Proposal have argued that the City should do what it can to alleviate poverty generally, there has been particularly strong sentiment about addressing poverty in Santa Monica itself. As noted earlier, Santa Monica has both great wealth and significant poverty within its borders, to an extent that is unusual (even unique) among the various Westside cities and communities that border Santa Monica Bay. A massive infusion of higher wages in the Coastal Zone, even if poorly targeted on poverty generally, might conceivably have a powerful impact on poverty in Santa Monica. This section explores that possibility.

Our data comes from the Public Use Microdata Sample (PUMS) of the 1990 census. The PUMS provides detailed information about a random sample of Santa Monica residents (about

5% of the City's 1990 population). Though dated now, the PUMS is an unusually detailed and reliable source of data about characteristics of individual households.

To protect the anonymity of people included in the PUMS database, the Census groups respondents into sizeable geographic areas, and does not say where in the area a particular respondent lives. These areas are known as Public Use Microdata Areas (PUMA). In 1990, Santa Monica was entirely in a single PUMA, but the PUMA also included a few communities in northwest Los Angeles County. Overall, Santa Monica residents made up about 55% of the population of the PUMA (but the City accounted for about 80% of persons in the PUMA below the poverty line). We therefore created a subsample of the PUMA that exactly matched the income distribution of households in Santa Monica (using household income to determine the probability of selecting a household for the subsample). This yielded a PUMS sample of 2200 households and about 4,000 residents, which by most other measures we could apply to it, closely resembled the makeup of Santa Monica's general population.

Within this sample, we could then identify people who would be likely to benefit from the Coastal Zone Proposal. Specifically, we selected any individual in these households who met the following criteria:

- Worked in one of the key affected industries: hotels, restaurants, department stores, clothing stores, bookstores, or misc. entertainment (to capture the Santa Monica Pier);
- Earned less than \$12 per hour (deflated to 1989 dollars);
- Had a commute of 15 minutes or less (on the theory that Santa Monica residents working in Santa Monica would generally reach their jobs in 15 minutes or less).

Our selection is overinclusive, of course. Many people who live in Santa Monica and have short commutes work in parts of Santa Monica outside the Coastal Zone, or in other Westside locations. But we believe that these selection criteria produce a relatively unbiased look at the sorts of workers most likely to live in Santa Monica and work in the Coastal Zone.

Results. One cannot look closely at the households of low-wage Santa Monica workers without realizing that they are a completely heterogeneous group. They resemble average Santa Monica households much more than they represent the poor. This is because, overwhelmingly, these workers come from households that have other, higher-earning members. Although the median worker in our sample earned only \$9,000 (partly because many of the workers were part-time), the median worker's household had a total income of over \$43,000 (in 1999 dollars). Less than one-tenth of these workers lived in poor families; most lived in households with incomes over three times the poverty line. In over a quarter of these households, the family had an income of more than \$100,000. For those low-wage workers in the sample who were living below the poverty line, the worker was usually living alone.

We conclude from this analysis that, to the extent Coastal Zone low-wage workers live in Santa Monica, they are even less poor and (on average) more affluent than their co-workers.

We can also estimate from this data the maximum impact the Coastal Zone Proposal could have on Santa Monica poverty. There are a total of nine workers in the PUMS sample for Santa Monica that are plausible Coastal Zone low-wage workers and who also are below the poverty line. Making the most generous assumptions we can, only a tiny proportion of poor households in Santa Monica would derive any direct benefit from the Proposal. Our best estimate is that, even assuming no job losses or displacement from the Proposal, poverty in Santa Monica would fall only from 9.2% to 8.7%.

The upshot of this analysis, then, is that the funds spent by firms complying with the Coastal Zone are likely to have only a modest dividend for poor residents within the City. To the extent the measure aims to alleviate poverty in Santa Monica, it is very poorly targeted.

Table 6.2: Comparison of Key Demographic Variables for Two Populations of Workers

Demographic Variable	Selected Workers in Los Angeles (CPS) (N=458)		Selected Workers in Santa Monica (PUMS) (N=94)	
	N	%	N	%
Householders	235	51.3	31	33.0
Poverty level				
0-50% poverty rate	3	0.7	4	4.3
50-99% poverty rate	66	14.4	5	5.3
100-149% poverty rate	88	19.2	11	11.7
150-199% poverty rate	93	20.3	8	8.5
200-299% poverty rate	118	25.8	17	18.1
Over 299% poverty rate	90	19.7	49	52.1
Race				
Asian	50	10.9	6	6.4
Black	9	2.0	1	1.1
Hispanic	325	71.0	19	20.2
Other	2	0.4	1	1.1
White	72	15.7	67	71.3
EITC Recipients	127	27.7	16	17.0
Median age	30		24	
Median Household Income	\$30,950		\$43,244	

*The CPS labels this variable as “Low Income.”

C. The Labor Substitution Effect on the Intended Beneficiaries

Up to this point, our consideration of who would benefit from the Coastal Zone Proposal has assumed that all of those currently holding jobs covered by the Proposal would continue to do so after the wage increases went into effect. This is not likely to be the case. First, as noted in Chapter Five, a substantial number of the current jobs in the Zone would probably disappear. Though we believe that most of these workers will find other employment, not all would, and those who do are more likely to move down than up in the income distribution.

Second, and more importantly, a wage increase of this magnitude would prompt employers to change hiring practices substantially. Workers who accept jobs for \$5.75 to \$7 per hour have substantially different skill sets than workers who make \$10-12 per hour. How these skills vary depends on the type of labor one is considering, but greater experience, greater skill, more education, and stronger English language skills tend to go up as wages go up.

This is one of the key ways that a government-mandated minimum wage increase has very different effects from a wage increase negotiated by a union and a business firm. In the union context, strong protections exist to insure that those who bargain for wage increases are the actual beneficiaries of the higher wages. With a mandated minimum wage increase, no such protections exist.

How much would higher-skill employees replace current workers? Nearly all of the employers with whom we talked understood very clearly that the pool of workers competing for jobs at their businesses would change substantially if the Coastal Zone Proposal were to become law. Employers told us consistently that however else their operations might change, they would certainly take advantage of the new pool to hire “better” workers.²⁷ We believe them, and we therefore assume that the workforce will change as existing workers are replaced.

A more difficult question is how rapidly this change will occur. At most of the lowest-paying jobs in the Zone, current turnover rates are around 50% per year.²⁸ But of course, if wages doubled, turnover rates would fall sharply, since the jobs would be much more valuable to their current occupants. The question, then, is whether firms will proactively take steps to replace current workers with higher-skill workers, or will let the process occur through a very gradual process of attrition. Again, a number of employers suggested that they would be fairly pro-active in replacing workers. But on this point, we are more skeptical. Our research on the Los Angeles Living Wage showed that while employers did often hire more skilled workers at

²⁷ As noted in the survey results reported in Chapter Five, 71% of the interviewed employers said it was “very likely” or “somewhat likely” they would hire more skilled workers (this was the most widely planned response to the Zone). In our case studies, the same theme emerged even more strongly.

²⁸ Note that even this turnover rate does not imply, of course, that all positions turn over every two years. Much of the job turnover is within the same half of the workforce; a modest fraction will stay with a job for many years, often gradually rising within a firm.

the higher mandated wages, and even put more demands on current workers, they rarely systematically got rid of current workers to hire new ones. Admittedly, the Los Angeles increases were less than half the size of those contemplated by the Coastal Zone Proposal, and there are more obstacles in the path of replacing workers under the Los Angeles program. Nonetheless, it seems more plausible to us that employers will replace existing workers only selectively, perhaps by reviewing each employee's performance around the time the new wage goes into effect and by setting somewhat higher work goals.

There will, then, be attrition and some outright replacement of the intended beneficiaries of the Proposal. The true beneficiaries, over the long run, will be higher-skilled workers. The only question is the speed with which this will occur. There is probably no way to definitely know this without performing the experiment. It seems obvious to us, though, that the workforce in the Zone would look quite different three or five years after the Proposal went into effect.

What this means is that, apart from the immediate loss of jobs likely to result from the Proposal, many of the current workers in the Zone will not be long-term beneficiaries of higher wages. The socioeconomic background, education, and ethnic character of the Zone's workforce will change.²⁹

Note that in this sense, raising wages through legislation of this type is fundamentally different than seeking to raise wages by forming a union and negotiating for higher pay. A union can more or less insure that the benefits of successful bargaining will be enjoyed by its members. When the government mandates a higher wage in the private sector, it cannot readily mandate exactly who will receive that higher wage.

D. Tax and Benefits Effects

When wages go up, so do taxes; some of the higher income a worker receives is passed on to the government. If the worker is in a low-income household, there is also a loss of some government benefits, such as food stamps, Medicaid, and subsidized school lunches for the worker's children. In assessing the overall effects of the Coastal Zone, we need to consider to what extent higher wages will translate into higher disposable income.

If all of the workers receiving wage increases came from low-income households, the increased taxes and lost benefits would amount to a very high marginal tax (and loss of benefits) from the higher, mandated wages. But as we have pointed out, the household incomes of these workers vary tremendously, and for many middle-income households the marginal loss is

²⁹ It is worth noting in this connection that, even with labor-labor substitution, it is very unlikely that Latino and black workers will be displaced en masse from the Zone's workforce. The fact is (as Table 6.2 corroborates) that racial minorities are distributed across the wage spectrum in Los Angeles; although Latinos certainly have a disproportionate number of the very low-wage jobs in Los Angeles, they also have a high proportion of medium-wage jobs.

relatively modest. To average these effects, we measured the average benefits received, and taxes paid, by the households of workers at a series of incrementally higher wage levels (see Table 6.3).

Table 6.3: Average Benefits Received and Taxes Paid by Low-Wage Workers

Benefits/Taxes	Wage Interval					
	\$4.00 - \$5.99	\$6.00 - \$7.99	\$8.00 - \$9.99	\$10.00 - \$11.99	\$12.00- \$13.99	\$14.00- \$15.99
Current Average Benefits*	\$1,625	\$1,416	\$1,128	\$785	\$558	\$546
Current Average Taxes*	\$682	\$1,107	\$1,743	\$2,622	\$3,844	\$4,243
Average Increase in Wages**	\$9,655	\$8,354	\$6,379	\$5,048	\$2,878	\$834
Average Decrease in Benefits**	-\$840	-\$631	-\$538	-\$227	-\$9	\$0
Average Increase in Taxes**	\$1,940	\$1,515	\$1,928	\$1,222	\$317	\$0
Overall Increase in Wages**	\$9,624,272	\$6,596,598	\$3,893,865	\$1,978,709	\$709,063	\$158,757
Overall Decrease in Benefits**	-\$837,312	-\$498,237	-\$327,588	-\$88,984	-\$2,352	\$0
Overall Increase in Taxes**	\$1,933,792	\$1,196,244	\$1,172,959	\$479,024	\$78,204	\$0

Source: Los Angeles, CA CPS 1996-1999.

*Actual figures based on the entire CPS sample (N=4,450).

**Estimations based on the actual figures for the sample of 576 workers in the selected industries of interest, weighted to approximate the Santa Monica workforce as described in Chapter Two.

By inspection of Table 6.3, we can roughly approximate the average tax and benefit effects of a higher wage. The average worker earning less than \$6 per hour currently receives benefits totalling \$1,625 per year, and pays state and federal income taxes averaging \$682. The average worker earning from \$10 to \$12 per year receives \$785 in annual benefits and pays \$2,622 in annual taxes. If we imagine a “typical” worker moving from the under \$6 category to the \$10-12 category, the net cost of lost benefits and higher taxes is \$2,740. If our typical worker is paid for 35 hours of work in an average week, the worker’s annual pay increase will be around \$9,000. Given the \$2,622 offset, the worker will “take home” about 70% of the net increase.

Overall, then, about 30% of the higher wages mandated by the Coastal Zone will not be

received by workers, but will be returned to state and federal governments in the form of higher taxes and lower benefits. There is civic merit in this, of course, since such consequences help society in general, but this effect also adds to the inefficiencies and the bluntness of the Coastal Zone Proposal as an instrument of general social policy.

Chapter Seven: Alternatives

Introduction. SMART leaders have emphasized at every opportunity that the Coastal Zone Proposal is not intended as a polished ordinance, but simply as a proposal that will generate discussion and refinement. And indeed, it is often easiest to understand the implications of one proposal by comparing it with another. We therefore turn, in this section, to a consideration of alternatives to the Coastal Zone Proposal, and variations upon it, that have the same general goal of helping low-wage workers in Santa Monica.

A. The Rival “Living Wage” Proposal

In the public debate that has gripped Santa Monica since the advent of SMART’s Coastal Zone Proposal, the most visible alternative has been the “Living Wage Initiative”, which we will call the “Initiative”. The Initiative has been developed and backed by Santa Monicans for a Living Wage, a coalition that includes a cross-section of residents but is probably most heavily backed by businesses affected by the Coastal Zone Proposal. (Although the Coalition has financed our study, the only information we have about the Coalition is that which is publicly available, which is to say, very little.)

The Coalition has advanced its Initiative as an alternative to (and preemptive strike against) the SMART Proposal. The Initiative has two notable features. First, it would mandate a wage of \$8.32 per hour for workers employed by city contractors (and a higher rate for employees without health insurance). Second, it would prohibit the City from adopting any other measure that mandates private sector wage increases unless the measure is adopted by voters in the citywide election -- thus preempting any legislation comparable in ends and means to the Coastal Zone Proposal.

Some proponents of the Initiative have suggested that it is broader and more universal than the Coastal Zone Proposal, because it has no geographic limitation (i.e., it applies to nearly all city contractors). SMART representatives have responded that the Initiative is a fraudulent living wage proposal, because its total impact would be tiny compared to that of the Coastal Zone. They view the Initiative as a ploy intended to fool voters who may cast ballots for it in November, thinking they are supporting a living wage while actually rendering the City Council impotent to enact any broader measure.

As in most vehement political debates, there is some truth and some distortion on both sides. We think the following basic facts are undeniable:

1) Substantially fewer workers would be covered by the Initiative than would be covered by the Coastal Zone Proposal. Proponents of the Initiative report that they are uncertain of the number of affected employees, because the City has not undertaken a study of the Initiative’s

impact and because the one hundred-odd contractors affected by the Initiative are reluctant to divulge to anyone else how many low-wage workers they employ. Professor Pollin suggests in his study that as many as eight hundred workers could be covered, but he also says the number could be under one hundred. No one believes that the number of affected workers would approach the number covered by the Coastal Zone Proposal. Moreover, the wage increases mandated by the Initiative are smaller than those mandated by the Proposal. It is thus misleading to claim that the Initiative is in any way (other than geographic) broader or more generous than the Coastal Zone Proposal.

2) However, the Initiative is not a “fake” living wage proposal. The national “living wage” movement has persuaded over thirty cities and counties nationwide to adopt “living wage” laws; nearly all of these laws are aimed exclusively at businesses that do business with the client city. In other words, the term “living wage” and the living wage movement have generally addressed the issue of how a city or county should conduct its own economic affairs. For example, living wage advocates often argue that if a city pays its own employees substantially more than the minimum wage, then it should make sure that government contractors, lessees, and subsidy recipients do no less. None of these other living wage laws have enacted sweeping minimum wage requirements that affect -- as would the Coastal Zone Proposal -- all businesses in a region, regardless of whether they do government work or not.

Between the Initiative and the Coastal Zone Proposal, it is the Initiative which falls much more closely within the general pattern of living wage legislation. True, the Initiative is narrower than many (though not all) living wage laws, because it excludes City lessees. But it is otherwise almost identical to living wage laws passed in the City and County of Los Angeles. The Coastal Zone Proposal, in contrast, is so different from other living wage laws that it is somewhat misleading to even use the term “living wage” to describe the Proposal. As we discuss in Chapter One, the Coastal Zone is better described as a minimum wage law.

3) Because the Initiative essentially regulates government contracting rather than private business, the costs of the Initiative would fall largely on the City (in the form of higher contracting costs).³⁰ Given the uncertainty about the number of covered employees, the cost of the Initiative could be anywhere between \$250,000 and \$3 million. Because the City directly bears much of the cost of the Initiative, the employment effects are significantly lessened.

4) The Coastal Zone Proposal, in contrast, does not have any immediate costs to the City, since it is a regulation of private business. Its huge (\$20-30 million) cost is almost entirely borne by businesses and (to the limited extent we discuss in Chapters Four and Five) by consumers. As Chapter Five explains, the effects on the City government are indirect losses of revenue, which take awhile to occur but then steadily grow over time. As we also discuss in Chapters

³⁰ Our detailed analyses of the Los Angeles Living Wage Ordinance have found that in government contracts affected by the Ordinance, the City has immediately absorbed, on average, about 50% of the cost of higher mandated wages and benefits. This proportion is likely to increase over time, as contractors seek to recover their earlier profit margins.

Five and Six, the Coastal Zone would have very large, and generally negative, effects on employment, business climate, and worker displacement.

5) Because the Coastal Zone Proposal is so vast compared to the Initiative's mandate on city contractors, the most significant part of the Initiative is its ban on other City wage regulation of the private sector. Consequently, the position one takes on the Initiative should, in our view, be primarily guided by whether one thinks the City Council will adopt something like the Coastal Zone Proposal, and whether one thinks that would be a desirable or undesirable step.

B. Wage Subsidies and the Earned Income Tax Credit

The most significant federal initiative against poverty over the last twenty years has been the Earned Income Tax Credit, or EITC. This program reaches some 50 million people and costs about \$25 billion per year. The EITC essentially provides low-income workers with a wage subsidy. In essence, the EITC gives workers a matching grant for their first \$4,500 to \$9,000 in earnings, with the threshold and amount of the subsidy depending on whether the worker has no children (small subsidy), one child, or two or more children (larger subsidy). If the worker's total household income (including other household workers) is above a certain level (\$13,000 for a household with two or more children), then the grant is taxed, with the grant being fully taxed away at an income of about \$30,000 for a household with two or more children. At its maximum, the EITC grant is about \$4,000.

The EITC has been an enormously popular program in Washington across the political spectrum. Presidents Carter, Reagan, Bush, and Clinton all sponsored expansions of the credit, and Vice-President Gore has proposed a modest further expansion. Three aspects of the EITC account for its popularity. First, it is extremely well-targeted; it is intended to help the working poor, and nearly all of its benefits go to that group. Second, it encourages low-income households to seek out work; a full-time worker earning \$6.00 per hour effectively makes \$8.00 per hour if he or she is eligible for the full EITC.³¹ Third, and unlike a higher minimum wage, it imposes no perverse incentives on employers because it has no effect on employers' costs; workers essentially get a raise paid for by the government. Thus, the EITC does not eliminate jobs, and gives employers no incentives to hire more skilled workers. Nor does it make businesses less competitive.

An EITC in Santa Monica. Several states across the country have implemented their own Earned Income Tax Credit programs that essentially piggyback on the federal EITC. We believe that it would be possible to do something similar in Santa Monica, and that a Santa Monica-sponsored EITC (or SMEITC) would be more effective than the Coastal Zone in furthering the

³¹ However, the EITC can discourage secondary workers from entering the job market in a low-income household, since the credit is taxed away at incomes above \$13,000. Studies have shown a small but real work disincentive in this "phase-out" range.

cause of redistributive justice and many of the other goals of SMART. An SMEITC would help working families, raise many workers above the poverty line, and improve worker-employer relations -- all without the harsh economic consequences of the Coastal Zone. Perhaps most importantly, the successful implementation of a SMEITC would attract wide attention, and might spur the state of California to join other states in adopting a statewide EITC.

How would a SMEITC work? There are many ways that a credit could be structured; we offer here two plausible approaches:

1) A credit for residents of Santa Monica. The City could adopt an ordinance entitling any Santa Monica resident to a City-funded credit equal to half of the federal EITC. The City would inform residents of the existence of the credit. Those receiving federal EITC funds would apply for the City credit by submitting (a) a copy of the applicant's federal tax return; and (b) a copy of the applicant's federal EITC check (nearly all EITC recipients currently receive the credit in an end-of-the-year lump sum). The City would then issue a check for half of the federal amount. The City may be able to share data with the California Franchise Tax Board to corroborate information on tax returns, as a way of minimizing fraud. The City may also require applicants to provide some suitable proof of residency.

2) A credit for employees of Santa Monica businesses and firms. The City could adopt an ordinance entitling any person primarily working within the Santa Monica city limits to a City-funded credit equal to half of the federal EITC. The City could hire outreach staff to contact all employers and identify workers eligible for an employer-sponsored version of the EITC known as the Advanced Earned Income Tax Credit, or AEITC. (Nearly anyone who is eligible for the federal EITC is also eligible to receive much of the credit in small installments during the year as a form of "negative withholding" on their paychecks, but only about 1% of eligible workers take advantage of this.) Employees eligible for the federal AEITC, and showing the documentation required by the IRS, could start receiving, through their employer, both the federal AEITC and the City-sponsored 50% match. The City would reimburse employers for all AEITC payments made. Workers seeking to receive the balance of their City-EITC payments would be required to submit the appropriate documentation at year-end.³²

³² The City would lack the IRS's ability to reclaim AEITC payments from workers whose household's total annual income exceeds the program's limits when tabulated at year-end. We suspect that the amount of overpayment occurring in this way would be very small, though, and there are a variety of corrective measures the City could take if, after the program starts, this proves to be a significant issue.

Table 7.1: Comparison of Key Demographic Variables for Three Populations of Workers

Variable	Selected Workers in Los Angeles Earning Under \$10.69/Hour (CPS) (N=458)		Selected Workers in Santa Monica Earning Under \$10.69/Hour (PUMS) (N=94)		EITC Recipients (PUMS) (N=102)	
	N	%	N	%	N	%
Householders	235	51.3	31	33.0	75	73.5
Poverty level						
0-50% poverty rate	3	0.7	4	4.3	21	20.6
50-99% poverty rate	66	14.4	5	5.3	34	33.3
100-149% poverty rate	88	19.2	11	11.7	28	27.5
150-199% poverty rate	93	20.3	8	8.5	16	15.7
200-299% poverty rate	118	25.8	17	18.1	3	2.9
Over 299% poverty rate	90	19.7	49	52.1	0	0.0
Race						
Asian	50	10.9	6	6.4	9	8.8
Black	9	2.0	1	1.1	5	4.9
Hispanic	325	71.0	19	20.2	27	26.5
Other	2	0.4	1	1.1	0	0.0
White	72	15.7	67	71.3	61	59.8
EITC Recipients	127	27.7	16	17.0	All, by definition	
Median age	30		24		34	
Median Household Income	\$30,950		\$43,244		\$11,417	

Cost and financing of a Residential SMEITC. How much would an EITC cost? According to the most recent IRS figures, about four thousand households in Santa Monica currently receive EITC payments. Our analysis of PUMS data suggests that the total value of these current benefits is roughly \$3 million. A 50% City-funded match would thus cost \$1.5 million. If the City engaged in effective outreach and increased participation in the EITC program by 10%, then the City-funded match would cost \$1.65 million (and residents would receive a total of \$4.95 million in EITC and SMEITC payments). Administrative costs would be significant, since the City does not have a pre-existing mechanism for processing household income data; we believe a reasonable estimate is \$250,000, for a total City of Santa Monica cost

of \$1.9 million.

How might such a program be financed? One answer is that a program benefiting the general population should be financed from general revenues. The City of Santa Monica currently enjoys a significant operating surplus; an intensely redistributive measure like the SMEITC would not be an unreasonable way to invest this surplus. Another alternative would be an increase in the TT&L tax currently levied on hotels. The hotels are currently profitable, enjoy some protection from increased competition, and, as we discussed in Chapter Four, would be better able to absorb increased costs than most other businesses in the City. A 1-point increase in the TT&L tax would generate close to the \$2 million in revenue needed to implement the residential SMEITC, while at the same time doing far less harm to the hotel industry than would the Coastal Zone Proposal.

Cost and financing of an Employer-Based SMEITC. The costs of an employer-based credit are more speculative. Santa Monica businesses employ some 68,000 workers. Again judging from IRS figures, probably only about one hundred of these workers currently receive the federal AEITC, though the number eligible to receive it is at least 5,000 (and possibly much higher). How much an employer-based AEITC would cost would depend on how effectively the City could increase participation in the federal AEITC. The upper-bound on benefits paid would be approximately \$2 million; what the lower-bound volume of benefits depends on how aggressively the City implemented the policy. Administrative costs would probably be higher under the employer-based program, since benefits would be processed throughout the year and the City would have to work with both employers and workers. The total cost of this program might be as high as \$2.4 million.

An employer-based SMEITC would provide some substantive benefits to Santa Monica employers, and these benefits would exist broadly in the business community. A logical way to finance such a benefit would therefore be a levy or set of levies that would be modest in aggregate impact and distributed widely. Possibilities include an increase in business licensing fees or a quarter-point increase in the sales tax.

Some comparisons: SMEITC vs. Coastal Zone. The SMEITC has enormous advantages over a Coastal Zone-style increase in minimum wages:

1) The SMEITC is extremely well-targeted at the families and households with the greatest need. Some 80% of the recipients (and nearly all of the subsidies) under an SMEITC would go to households under 150% of the poverty line. By comparison, only 20-35% (depending on whether we use Los Angeles or Santa Monica data) of the Coastal Zone workers earning less than \$10.69 are in households under 150% of the poverty line. None of the SMEITC goes to households with incomes more than double the poverty line; at least half of the Coastal Zone-mandated wages would go to such households.

2) The SMEITC would have positive effects on workers -- improved standards of living, better motivation, and perhaps higher productivity -- without the harmful consequences on

employers and employees alike that result from high mandated minimum wages. With an SMEITC, employers have no incentive to replace workers and suffer no adverse consequences on business operations. Job losses would be zero. Indeed, an employer-based SMEITC would make Santa Monica a more appealing place in which to operate a business, because the City helps employers boost take-home pay above what similar jobs would pay elsewhere.

3) The SMEITC will tend to produce a net inflow, rather than a net outflow, of government benefits and taxes into Santa Monica. As noted in Chapter Six, a \$20 million increase in wages for workers in the Coastal Zone would produce something like a \$6-7 million export of lost benefits and higher taxes to areas outside Santa Monica and Los Angeles County. The SMEITC, in contrast, would almost certainly lead to an increase in the utilization of the EITC among Santa Monica residents or workers; and this increase would probably more than offset any loss of benefits, or higher taxes, paid by the City credit's recipients.³³

The SMEITC has some disadvantages, too. The credit is "phased out" as household incomes pass \$13,000; recipients of the new credit would thus face a higher marginal tax on their earnings as in the range of \$13,000 to \$30,000 in household income. And the credit is paid by public revenues rather than private business, making the costs more visible to the public. But this visibility is in many ways a virtue: if Santa Monicans believe their community is affluent enough to take extra steps in helping the poor, it is appropriate, we think, for them to take direct responsibility for those steps.

³³ We have not yet ascertained whether the benefits paid under piggyback-EITC measures in many states are exempt from federal payroll and income taxes (as is the federal EITC).

Chapter Eight: The Pollin Report

The City of Santa Monica sought and commissioned an economic study of the Coastal Zone Proposal. The study was conducted by Professor Robert Pollin, an economist at the University of Massachusetts at Amherst working with a team of researchers. Professor Pollin completed, and the City released, his study during the final edits of this report. Despite the limited time we had available to digest his massive product (254 pages of text with another 120 pages of figures and tables), we feel our own study would be incomplete with some commentary on his.

Professor Pollin's conclusions are almost diametrically opposed to our own. In his report he argues that the Coastal Zone Proposal would have relatively modest effects on the regulated businesses while effectively helping families in great need. He contends that hotels will not be seriously affected because they can readily raise prices to cover the higher costs and because they will reap substantial productivity gains from better-paid workers. He believes retailers will not be seriously affected because the higher labor costs would represent a tiny proportion of total revenues for most retailers. And he believes the impact on restaurants would be small because only a few restaurants are covered by the Proposal, because these, too, could raise prices, and because the effects on restaurants could in any case be mitigated by exempting tipped employees.

Professor Pollin is equally confident that the Coastal Zone Proposal would hurt few workers and will reach predominantly needy families. He contends that the median household income of Coastal Zone workers is only \$20,000, and that nearly all of the workers have household incomes under what he calls the "L.A. basic needs income" (\$45,683 for a family of four). He comes up with a variety of estimates of how many jobs would disappear in the Coastal Zone, but all the estimates are low and he believes that the unemployed would readily find jobs elsewhere. And, finally, he believes that relatively few employers will replace their former low-wage employees with higher-skill workers if higher wages are mandated.

It must be disturbing to most readers to learn that two sets of economists hired to study the same proposal come to such different results. It suggests, perhaps, that data and theory can be manipulated any way an author likes. But we disagree: we think that while it is hard to know for certain the effects of a Coastal Zone that hasn't been tried anywhere else, the use of sound economic methodology can produce some fairly clear, unambiguous results. Professor Pollin's conclusions are different from ours because he made specific methodological, definitional, and research choices that we believe nearly all economists would reject.

What follow are key problems in the Pollin Report that explain (and in many cases invalidate) his distinctive conclusions:

- 1) Professor Pollin believes hotels can pass on higher costs by simply raising prices, with no negative consequences for occupancy rates and employment, and quite possibly with positive consequences. Put another way, Professor Pollin is arguing that, in the case of hotels, the law of

demand is repealed. The law of demand, which simply states that the quantity demanded of any good is inversely related to its price is perhaps the strongest proposition in all of economics. No college freshman can pass an introductory economics course without a conceptual understanding of why the law of demand is so robust empirically.

Professor Pollin draws his conclusion through a “time-series” analysis of data showing that, over the past decade, hotels in Santa Monica have been able to raise their room rates even as their occupancy rates have gone up. From his analysis, he concludes that somehow these hotels have upward-sloping demand curves -- that the higher their prices go, the more customers they will have. What Professor Pollin fails to recognize is that he could just as easily be tracing out a supply curve (which economic theory does predict slopes up) or, more likely, an interaction of demand and supply, which are themselves shifting over time. In the technical language of econometrics, Professor Pollin’s analysis suffers from an “identification” problem. In plainer language, Professor Neumark (one of the City’s economic reviewers) correctly notes it is “simply wrong and would not survive professional scrutiny.” Yet, despite the fact that economists reviewing a draft of his report pointed out this fatal flaw, Professor Pollin kept it in his final report; indeed, he relied heavily upon it.

How can we explain his result? The reason for the positive correlation between room rates and occupancy is actually very simple. The Santa Monica hotels are currently riding the crest of a remarkable period of economic expansion, and a period where the growing popularity of the Third Street Promenade and the upgrading of hotel quality on the oceanfront have made some of the Santa Monica hotels competitive with other premier Westside hotels. In other words, the demand for Santa Monica hotel rooms has over the past 5 years consistently exceeded the available supply of rooms. When this has happened, hotels, in a manner very consistent with economic theory, have increased their prices to ration out the available supply of rooms and to bring demand more in line with supply. It is important to keep in mind that hotels do not have unlimited capacity to raise rates - - otherwise, of course, they already would have done so. As with nearly all other businesses, the hotels set prices as high as competitive conditions, and the need to maintain optimal occupancy levels, will permit.

2) Professor Pollin contends on page 87 of his report that the hotels would realize “20-25%” gains in productivity as a result of the higher wages mandated by the Coastal Zone Proposal. The idea of improved productivity is an important one, and of course, we discuss it at some length in Chapters Three and Four. In principle, it makes sense that higher wages would produce some increase in productivity. However, after conducting careful case studies of businesses in the key sectors of the Coastal Zone, we concluded that productivity gains would be very hard to realize in any of these businesses. None of these businesses are particularly capital intensive, and greater use of capital is a key catalyst for productivity improvements.

So how does Professor Pollin come to such a different conclusion? As far as we can tell, he simply made his numbers up. He does not describe how he measured productivity changes in the Coastal Zone, or give any case studies of productivity improvements. He does suggest that lower

turnover will improve productivity, but he provides no evidence that current training costs amount to 20-25% of all labor cost. Indeed, we could find no evidence that Professor Pollin studied the internal operations of any actual business operating in the Zone.

Let us suppose for a moment, however, that Professor Pollin is right -- hotel and restaurant workers will become 20-25% more efficient as a result of the higher wages. Would this not imply that hotels would be able to get by with 20-25% fewer workers? This unpleasant side effect apparently never occurred to Professor Pollin.

3) Contrary to our analysis, Professor Pollin contends on page 61 that retailers operating in the Coastal Zone would not be much affected by the mandated wage increases because the total cost would only represent about 2% of their total revenues. The flaw in his analysis lies not so much in his estimate as in his logic. The “2%” figure is low, but probably in the correct ballpark: we estimate in Chapter Two that the wage increases will cost retailers from 2 to 5%, depending on the sector considered. But to leave the story there is tremendously misleading, since the relevant question for predicting business decisions is not how the wage costs relate to revenues, but how the wage costs relate to total profits. If a business has a profit margin that is only 3% of total revenues, then a 2% increase in costs would be devastating to profits.

Moreover, a figure like “2%” (for the ratio of new wage costs to revenue) is only an average. Suppose that the correct average figure is closer to 4%, and suppose that this ranges among the retail firms in the Zone from 1% to 7%. Suppose that most of the firms facing 6% or 7% ratios have profit margins of 4-5%. It is plausible that firms in this situation will very seriously consider closing or relocating. This is, indeed, exactly what we find is likely to happen for at least one major retailer, with the resulting loss of hundreds of jobs.

4) Professor Pollin finds more hotels, and fewer restaurants, will be covered by the Coastal Zone than we do. The reason for this difference is that he does not directly measure the 50-employee threshold found in the Coastal Zone Proposal; instead, he uses a \$3 million revenue threshold to determine who is covered, and who is not. A \$3 million threshold, compared to a 50-employee threshold, will tend to cover more capital-intensive businesses (like hotels) and cover fewer labor-intensive businesses (like restaurants). While we agree with Professor Pollin that a revenue threshold has some advantages over an employee threshold (it discourages attempts to evade the regulation by reducing workforce size), it is odd that he does not even seek to measure the extent of the Coastal Zone Proposal in its current form.

5) Professor Pollin believes that the Coastal Zone wage increases would do a good job of helping the neediest workers in Los Angeles. He believes this in large part because he conducted a survey of workers in the Coastal Zone and found that the median reported household income of these workers was \$20,000 -- much lower than the \$31,500 - \$40,000 range we estimated from CPS and PUMS data. The problem with Professor Pollin’s survey is that it is completely unscientific. Without random sampling, there is no assurance that his survey results are at all representative of the target population. Apparently research assistants on the project simply approached people who

struck them as likely workers in covered businesses in the Coastal Zone, and asked them about their household income. Even if we ignore the unmeasurable selection bias built into this process, the reported data on household income is simply not credible. Compared to the Current Population Survey, which conducts in-home, detailed interviews over four successive months on all aspects of household earnings and income, a casual on-the-street survey is an invitation to substantial underreporting of income. That underreporting occurred is evidenced by the fact that the average respondent reported 1.9 workers in his or her household. As Professor Neumark points out, if one tries to reconcile this statistic with a \$20,000 median household income, the implication is that virtually everyone in virtually all of these households made no more than the minimum wage -- which is itself belied by other statistics in the Pollin Report. We agree with Professor Neumark that these results are internally contradictory.

6) Professor Pollin also suggests that anyone earning less than the “L.A. Basic Needs Income” is a low-income person worthy of being targeted for assistance by policies like the Coastal Zone Proposal. This income threshold is \$45,683 for a family of four, and \$37,589 for a family of three. We agree with Professor Pollin that Los Angeles is an expensive place to live and that existing poverty lines are too low. But \$45,683 is well above the median household income for Los Angeles. To say that anyone with an income less than the median is “needy” tends to render the debate meaningless. The point in question is how well a proposal like the Coastal Zone raises incomes of those most in need. Our analysis does a much better job of addressing that question, and shows that the Coastal Zone is very poorly targeted if its primary goal is income redistribution.

7) Professor Pollin claims that the Coastal Zone Proposal will not cause significant unemployment. He bases this partly on the claims we have already discussed (e.g., hotels can raise prices to cover the cost without losing customers). He also engages in a general analysis of the problem, using economic measures of labor “elasticity” (the propensity to use fewer workers as costs rise) developed by leading labor economists who have worked on these issues. The problem is that Professor Pollin uses these techniques incorrectly. For example, he takes the total number of employees at affected hotels (1262 by his count) and then multiplies this total by the “percentage of firms likely or somewhat likely to layoff workers”, which is 62%. He then applies elasticity measures to this lower number.

This technique shows that Professor Pollin does not understand what labor elasticity means. An elasticity is a measure of an overall market’s response to price changes. The fact that some firms are “unlikely” to lay off workers is why the elasticity is less than 1. To take these firms out of the base by which elasticities are multiplied is a fundamental and -- to most economists -- obvious error.³⁴

³⁴ An analogy may be helpful. Suppose one is trying to determine how many of one hundred people sitting in a room are liberals. One administers a confidential survey and learns that 30% of those in the room identify themselves as liberal. By Professor’s Pollin reasoning, one would then ask for a show of hands of how many people in the room consider themselves “left of center”, and then would multiply 30% times this number.

8) Professor Pollin concedes that firms would have a significant incentive to replace low-skill workers with higher-skilled workers once higher wages are mandated. But he believes the actual extent of such changes will be small. He bases this partly on a demographic analysis, which suggests that the “observable” characteristics of high-wage workers are not dramatically different than the characteristics of low-wage workers. We disagree that that these differences are always small, but in any case Professor Pollin’s premise is incorrect: the mere fact that a high-wage worker speaks English as a second language and has only a high school diploma does not mean that this worker does not have greater skills than a low-wage worker with the same demographic characteristics. Wage premiums are paid for a reason, and employers will want the best workers they can get for the wages paid.

Professor Pollin also suggests (page 95) that the Coastal Zone firms would be in a position similar to that of a firm facing unionized workers who have just secured a pay raise. Such a firm, he argues, is not likely to fire large numbers of unionized employees to hire workers with higher skills. This is correct, but it hardly seems relevant to the situation facing Coastal Zone employers. In the union case, raises are negotiated with an existing workforce, by contract, with protections for existing workers. How this example could seem apposite is a mystery to us.

Most remarkably, Professor Pollin suggests that whatever displacement does occur will impose no more than a passing trauma on the workers concerned. Since the Coastal Zone Proposal will not cause any “net” reduction in jobs in Los Angeles, he claims “the 1.3 million person low-wage labor market in the Los Angeles metropolitan area should offer opportunities for displaced workers at least comparable to their Coastal Zone jobs.” This is simply incorrect, for reasons we explain in Chapter Five; in fact, it is probable that about one third of the jobs lost in Santa Monica will not be offset by job gains elsewhere. Such complacency about the consequences of large-scale job loss seems odd, coming from the pen of Professor Pollin.

We hope that these points make clear why Professor Pollin’s findings differ from our own. We could offer many more examples of misleading or incorrect analyses in his report, but we are constrained by space and time. Overall, we agree with Professor Neumark’s conclusion about the Pollin Report: “...I have enough criticisms of this study to believe that it provides an insufficient basis to draw strong conclusions about the likely effects of the living wage proposal. In contrast, I think the authors overreach, and draw conclusions that cannot be supported by the data and methods they use.”

Chapter Nine: Conclusion

Economists have a long and well-known hostility towards the minimum wage, and it would not be hard to find respected labor economists who would dismiss the very idea of the Coastal Zone as a crackpot scheme not even worthy of serious thought. We hope it is clear that this has not been our approach. We recognize that research over the last decade has eroded some of the assumptions economists use, and we also recognize that the Coastal Zone is an unusual local market that is, in some senses, better suited to the kind of experimentation proposed by SMART.

The Coastal Zone Proposal, if enacted, would probably not devastate the local economy of the Zone; it would not do as much harm on the Santa Monica beachfront as it would in Long Beach or Bellflower or Burbank. Most of the businesses in the Zone would pay the higher wages, some would probably unionize, and there would be a large transfer of income from employers to workers. To this extent, the goals of the Zone's proponents might be realized.

Nonetheless, the overall effects of the Coastal Zone Proposal would be very costly and so harmful that we believe even its most zealous proponents would not conclude that the gains were worth the price. **We summarize these costs and consequences in Chapter One.** Foremost among the effects are these:

- Employment in the Zone would fall by roughly 15%, or about one thousand jobs. This effect might be lessened by a fall over time in property values and lease rates.
- Property tax revenues will fall, over time, by \$4-5 million.
- A substantial proportion of current employees of Coastal Zone employers would be displaced by the hiring of new workers who are perceived to have stronger job skills.
- The beneficiaries of the higher wages would, overwhelmingly, not come from poor households or families. The impact on poverty in Santa Monica, in particular, would be miniscule.

As we discuss in Chapter Seven, there is an alternative policy that has virtually none of the negative economic effects of the Coastal Zone Proposal, is much less costly, and yet targets its benefits so well that it would have a much greater impact upon poverty in the community and upon low-income, working families. This alternative is a City-based Earned Income Tax Credit, which we call the Santa Monica EITC.

Santa Monica is an unusually progressive city. The SMART movement evidences both a desire to share more widely the City's remarkable prosperity and to set an example for the region and beyond of how a prosperous community can help its least fortunate members. We think that

a Santa Monica EITC could have just this effect. Several states have already piggybacked modest state-funded credits to the federal EITC. A generous and successful Santa Monica EITC could help propel a serious effort in California to create a statewide EITC, which would have the potential to lift over one hundred thousand families out of poverty while encouraging work, helping business, and incurring only modest fiscal burdens. It is down this more constructive path, we hope, that Santa Monica will choose to lead.

Appendix I

This appendix contains tables that supplement the analysis in Chapter Two. See the text of that chapter for details.

Table A.1: Distribution of Job Types within Retail and Service Industries in Los Angeles County for Companies of 20 or More Employees (cell entries are percentages)

Job type	Retail				Service							Total
	Dept. Store	Apparel & Shoes	Eating & Drinking	Other Retail	Finance, Insurance, Real Estate	Business Services	Hotels & Lodging	Other & personal services	Entertainment	Health Services	Legal Services	
Managerial	10%	1%	10%	6%	38%	20%	14%	49%	54%	44%	47%	32%
Technical				2	2	3	1	2	2	12	15	3
Sales	45	57	10	36	14	5	3	1	10	1		10
Admin	11	5	1	8	30	17	9	17	14	18	35	16
Protective	1				1	7		3			1	2
Food Prep & Service			69	1			27	1	3	3		7
Health						1		1		13		2
Cleaning & Building	2		1	1	1	8	24	2	2	4	1	3
Personal		1		1	1	1	2	5	7			2
Precision Production	10	8	1	9	4	15	5	2	4	1		5
Operators	10	4	3	20	1	17	5	3	3	2		6
Supervisors	10	23	5	16	6	2	6	2			1	4
Other	1	1			2	4	4	12	1	2		8
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.2: Percentage of Workers Earning Less Than \$10.69 Per Hour by Job Type
(Includes only respondents employed in industry sectors listed in table A.1; N is unweighted)

Job type	Percentage earning less than \$10.69 per hour.	Standard Error of estimate	N
Managerial	18%	1%	852
Technical	29%	4%	171
Sales	60%	2%	558
Admin Support	53%	2%	875
Protective	47%	5%	109
Food Prep & Service	65%	2%	466
Health Service	64%	4%	119
Cleaning & Building Service	72%	3%	192
Personal Service	80%	4%	125
Precision Production & repair	60%	3%	282
Operators	74%	2%	400
Supervisors	33%	3%	246
Total	41%	1%	4395

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.3: Distribution of Wages among Workers earning Less Than \$10.69 Per Hour by Job Type
(Includes only respondents employed in industry sectors listed in table A.1; N is unweighted)

Job type	\$6 or less	\$6.01 to \$7.50	\$7.51 to \$9.00	\$9.01 to \$10.68	N
Managerial	31%	15%	21%	33%	158
Technical	30%	23%	13%	34%	51
Sales	48%	24%	15%	12%	353
Admin Support	29%	22%	20%	29%	471
Protective	36%	28%	22%	14%	52
Food Prep & Service	45%	18%	23%	12%	311
Health Service	44%	20%	25%	11%	78
Cleaning & Building Service	46%	24%	19%	11%	145
Personal Service	53%	19%	11%	17%	100
Precision Production & repair	34%	22%	21%	23%	167
Operators	46%	28%	15%	11%	297
Supervisors	29%	19%	23%	29%	87

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.4: Percentage of LA County Workers Making Less Than \$10.69 Per Hour by Industry (N is unweighted)

Industry Sector		Percentage earning less than \$10.69 per hour	Standard Error of Estimate	N
Retail				
	Dept. Store	58%	5%	112
	Apparel & Shoes	61%	7%	81
	Eating & Drinking	67%	2%	529
	Other	59%	2%	703
Service				
	Finance, Insurance, Real Estate	31%	2%	584
	Business Services	56%	2%	701
	Hotels & Lodging	67%	4%	132
	Other & Personal Services	41%	1%	1747
	Entertainment	34%	3%	347
	Health Services	33%	2%	627
	Legal Services	16%	4%	101
Total		45%	1%	5664

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.5: Distribution of Wages among Workers Making Less Than \$10.69 Per Hour by Industry in Los Angeles County (N is unweighted)

		\$6.01	\$7.51	\$9.01		
Retail						
	Dept. Store	33%	15%	22%	29%	65
	Apparel & Shoes	48%	27%	13%	12%	52
	Eating & Drinking	49%	20%	21%	9%	360
	Other	41%	26%	15%	18%	432
Service						
	Finance, Insurance, Real Estate	28%	14%	28%	30%	189
	Business Services	40%	23%	17%	20%	405
	Hotels & Lodging	33%	22%	20%	26%	86
	Other & Personal Services	44%	20%	16%	20%	765
	Entertainment	44%	17%	21%	19%	119
	Health Services	30%	25%	24%	21%	225
	Legal Services	47%	7%	18%	28%	19

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.6: Percentage of Workers Receiving Employer-provided Health Insurance by Industry and Wage in Los Angeles County (N is unweighted)

	All Employees	Employees making less than \$10.69 per hour		
Industry Sector	Percent receiving health insurance	Percent receiving health insurance	Standard error of estimate	N
Retail				
Dept. Store	43%	31%	6%	65
Apparel & Shoes	37%	27%	9%	53
Eating & Drinking	20%	15%	3%	365
Other	54%	25%	3%	435
Service				
Finance, Insurance, Real Estate	62%	40%	4%	194
Business Services	39%	21%	3%	408
Hotels & Lodging	56%	50%	6%	86
Other & Personal Services	54%	24%	2%	778
Entertainment	62%	33%	5%	121
Health Services	59%	42%	4%	227
Legal Services	67%	15%	24%	19
Total	49%	26%	1%	2751

Source: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics.

Table A.7: Estimated Change in Payroll Attributable to Wages and Increased Health Insurance Costs if Minimum Wage Increases to \$10.69 Per Hour and Employer-provided Family Health Insurance Coverage Is Mandated for Low Wage Workers in Los Angeles County

	Percent increase in payroll due to wage increases	Percent increase in payroll due to health insurance
Retail		
Dept. Store	14%	7%
Apparel & Shoes	22%	9%
Eating & Drinking	34%	14%
Other	16%	7%
Services		
Finance, Insurance, Real Estate	4%	2%
Business Services	14%	6%
Hotels & Lodging	21%	6%
Other & Personal Services	8%	4%
Entertainment	5%	N/A
Health Services	6%	2%
Legal Services	2%	1%
Total	14%	8%

Sources: 1996-1999 Current Population Survey, pooled file, Bureau of Labor Statistics; estimates of health insurance costs from text.

Survey Number	
---------------	--

Appendix II

UCLA Study of the Santa Monica Minimum Wage Survey of Potentially Affected Businesses

We appreciate your taking the time to answer the following questions:

1. What is the total number of employees working in your company (in Santa Monica only)?
2. What is the current market valuation of your business?
3. What is the current tax valuation of your business?
4. What are the current annual revenues of your business?

Now please complete the table on the next page by dividing the total number of employees stated above according to your firm's internal categories (examples of possible categories which your firm might use: housekeepers, servers, maintenance etc).

Job Categories	Full or Part Time	Total number of employees within this category as of the time of survey	Average hourly wage rate for this category	Average hours worked per week for this category	Average Months per year employed (if seasonal) for this category	Average weekly amount of tip earnings or commission for this category (if relevant)	Number of employees in this category whose salary package includes health insurance	What percentage of this health insurance does the employer contribute	Average employer dollar contribution to the health insurance package	How many workers in this category are unionized
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									
	Full									
	Part									

We would like to get a sense of what consequences you foresee for your business should the proposed minimum wage law be implemented by the Santa Monica City Council. Below is a list of possible consequences for your business (or actions you feel you would need to take) in response to a rise in the minimum wage from \$5.75 to \$10.69. Please circle the most appropriate response from the choices given below:

1. Increase prices

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

If you are very likely or somewhat likely to increase prices, by what percentage would you increase prices?

2. Reduce staff

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

If you are very likely or somewhat likely to reduce staff, how many employees would you lay off?

3. Close down completely

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

4. Move out of the minimum wage zone

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

5. Outsource more

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

If you are very likely or somewhat likely to outsource, how many positions would you outsource?

6. Restructure the company to bring within 50 employees without reducing staff

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

7. Hire better quality workers since the wage is higher

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

8. Redefine job roles and expect current employees to do more, and do it better

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

9. Cancel planned expansions, or expand elsewhere

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

10. Encourage workers to join a union

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

11. Reduce Current benefits to offset cost of mandated benefits

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

12. Replace tipping practice with fixed service charge

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

13. No change

Very likely	Somewhat likely	Somewhat unlikely	Very unlikely
-------------	-----------------	-------------------	---------------

Further Comment:

About the Authors

Richard H. Sander is a professor of law at UCLA specializing in the empirical study of social policy. He was educated at Harvard University and Northwestern University, and holds a doctorate in economics as well as a law degree. He is a co-founder and current president of the Fair Housing Institute, which has brought a number of successful civil rights lawsuits and works with cities to develop better housing policies. At UCLA, Sander is director of the Empirical Research Group, which undertakes collaborative research projects on law and policy. Sander studied the Los Angeles Living Wage Ordinance when it was first proposed, and helped to oversee and study its implementation. At his urging, the City of Los Angeles started a program to increase local use of the federal Earned Income Tax Credit; the program has generated millions of dollars in increased income for low-income families in Los Angeles.

E. Douglass Williams is an Assistant Professor of Economics at the University of the South in Sewanee, Tennessee. Williams has a doctorate in economics from Northwestern University, where he specialized in labor economics. In addition to coauthoring with Sander the 1997 study of Los Angeles' proposed living wage ordinance, Williams has published studies of anti-poverty policy and the market for lawyers. From 1997 to 1999, he served as the economist for the City of Milwaukee, where he advised city officials on regional economic, tax, pension, collective bargaining and other policy issues.

Joseph Doherty is a doctoral candidate in Political Science at UCLA, and the Associate Director for Research of the Empirical Research Group at the UCLA School of Law. His areas of expertise include public opinion and voting behavior, elections, and quantitative research methods.

Before attending UCLA, Doherty clerked in the Santa Monica City Attorney's office (1990-1993). For many years, Doherty has also been a consultant for Fairbank, Maslin, Maullin, and Associates, a Santa Monica-based public opinion and research firm.