Growth & Justice
Wage Project Briefing Report
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INTRODUCTION: This Growth & Justice briefing paper presents background information related to the question, ***"How can we increase the number of working people in Minnesota who can support their families on a basic-needs budget?"*** It describes the current situation, introduces a return-on-investment analysis of moving people up the wage ladder, and examines a number of current policies designed to create more high-wage jobs, to move people up the wage ladder, or to subsidize the wages or reduce the expenses of low-wage parents.

This paper was written by Joel Kramer, Growth & Justice Executive Director, with research assistance from Ryan Pesch, Eileen Weber and Brian Pittelko. It is based on secondary research, and is not meant to be comprehensive. Its purpose is to give a base of knowledge to participants in discussions on this policy subject. As you read the briefing paper, keep in mind these questions that will guide our discussion.

QUESTIONS FOR DISCUSSION:

1. Should increasing the number of working people who can support their families be a key goal for Minnesota public policy? If not, why not?
2. Imagine that we were designing a comprehensive set of policies to make this goal a top priority. Based on what you know now….
   a. What would its philosophy and goals be? (Keep in mind that we want to combine policy effectiveness with political feasibility, defined by level of public support.)
   b. What would its key components be?
   c. Which current programs should be revised, deemphasized or eliminated?
   d. How much should we spend on our policies or plan, and why?
   e. Where would we get the money?
   f. What would you call it?
3. What are the risks of adopting such a plan?
4. What more should we know to do the best possible job of designing such a plan?

I. Current Situation

From 1960 to 2000, Minnesota had a remarkable economic track record compared to the nation. In 1960, per capita personal income in the state was less than 95% of the national average, and we ranked 24th among states. In 2000, Minnesota personal income exceeded the U.S. average by 8.5%, and we ranked 9th.

Growth was especially strong in the 90s. Minnesota's gross state product expanded 43% from 1990 to 1999, while U.S. Gross Domestic Product grew 35%. Real per capita income grew 22%, compared to 15% nationally. Between 1990 and 2000, Minnesota employment grew 25%, but the labor force expanded only 15%, creating a record-low unemployment. The unemployment rate hovered around 5% at the beginning of the 90s, and 3% at the end.[1]

On one measure of worker productivity, output per job, Minnesota grew faster than the nation in the 90s (18% real, vs. 15%, with especially strong results in the second half of the decade), but at the end of the decade remained about 10% below the national average.[2]

Real average wages in Minnesota grew 1.4% a year in the 1990s, higher than the national growth rate of 1.1%. In 2000, the average annual wage in Minnesota was $35,418, 12th highest in the nation.

However, averages mask important variations. From 1980 to 1998, the average income of the bottom fifth of Minnesota households was virtually unchanged, after adjusting for inflation, while the middle fifth rose 17% and the wealthiest fifth rose 43%.[3]

The poverty rate in Minnesota is lower than the nation's. In 2000, it was 7.9%, compared with 12.4% for the nation.[4] But it is widely agreed that the poverty line is drawn too low. It was developed decades ago using the formula of multiplying food costs times three, but today food constitutes only about a fifth of a struggling family's costs, and other categories – such as health care and housing – are rising much faster than the cost of food. That's why most government programs today cover families well above the poverty line – the reduced-price school lunch program, for example, has an eligibility limit of 185% of the poverty line. Some programs use 200%.

Basic-Needs Budget

A better way to understand the struggle of families is to build a budget from the bottom up. JOBS NOW Coalition does that for Minnesota families.

Their basic-needs budget is no-frills, but not bare subsistence. It includes no money for eating out, savings, education beyond high school, vacations, life insurance or a down payment on a house. It does include 40th percentile fair-market rent, health insurance, child care (except where one parent doesn't work) at the regional average price, and basic transportation, clothing, and household maintenance items. It also includes taxes paid and tax credits received.

JOBS NOW will soon update its calculations. But based on the 1999-2000 data, for a single mother with two young children, the basic-needs budget requires $17.76 an hour in the metro, $14.76 in Greater Minnesota, for a statewide average of $16.36 an hour. For a family of two adults and two children with only one parent working, it's $16.12 an hour in the metro and $12.98 in greater Minnesota, for an average of $14.65. These numbers are lower because there is no child care cost included. For two parents, both working, with two young children, they need to make a combined $22.43 in the metro, $18.88 in Greater Minnesota, and $20.76 for the statewide average. So, two equally paid parents in the metro area would have to earn $11.22 an hour each.[5]

How are we doing?
In the year 2000, almost 31% of Minnesota workers earned an hourly wage less than $10 an hour, which means that if they worked 40 hours a week, they could not provide their half of the income needed to support two kids and two adults at a basic-needs level . Fifty-five percent earned less than $15 an hour – not enough to be a single parent supporting two children. The median hourly wage was $14.45, just under what was needed to support a family of four with only one parent working. In the current recession, wages are under pressure. Nationwide, the inflation-adjusted weekly pay of the median worker fell 1.5% from early last year to early this year.

This, then, is the central issue of our project. More than a third of Minnesota workers are not earning enough to support a family with two kids on a basic-needs budget, and more than half can't be the sole support of a family.

By focusing on people who are working, we are not addressing all the issues relating to struggling families. In the current downturn, unemployment has risen. Over the last two years, the number of job openings has declined from 88,000 to 32,000, and there are now more job seekers – 55,500 – than vacancies, reversing the situation of a few years back. And this does not even account for people who have given up looking for work.[6]

However, for every unemployed Minnesotan, there are 10 who are working and not earning enough to support a family. Few policy goals would have more effect on the well-being of our state than increasing the number of working people who can support a family at a basic-needs level.

II. Economic Rationale for Moving Low-Income People Up to Higher Wages

If we knew how much the state benefited financially when a person or family moved up the wage ladder, we could measure the return on investing public money in improving wages. Unfortunately, no one calculates the benefit with any thoroughness, because so little emphasis is placed on measuring return on investment of public programs.

In 1995, Twin Cities Rise! asked the Minnesota Planning Department to do such a calculation for its private program to train low-income workers for high-paying jobs. Department staff did the calculation, and TCR used it to argue successfully for state support. The Planning Department never published the results, nor has it updated them. But their findings were fascinating.

The analysts concluded that if a person with dependents earning $5 an hour (about minimum wage) could move up to a job paying $10 an hour, it would save the state $4,800 a year. This included $200 in additional state income tax collections, $300 in additional sales tax, $3,3,00 in reduced welfare payments and an estimated reduction in costs dealing with crimes and incarceration of $1,000.[7]

This $4,800 understates the state's savings, because of what economists call the multiplier effect. If the higher-wage person spends an additional $10,000 a year, that spending will generate additional economic activity by the businesses and employees receiving the $10,000. A recent U.S. Labor Department study concluded that each $1 given to a laid off worker in unemployment benefits generates $2.15 of economic activity.[8] If all that activity occurred in Minnesota in this case, that would mean still another $11,000 of spending, generating hundreds more in state taxes. In addition, the increased borrowing capacity of the $10 an hour wage-earner would increase sales of homes, cars and other big-ticket items, further fueling segments of the Minnesota economy.

Even using the $4,800 number, a state investment of $4,800 to create that move up the wage ladder would pay for itself in one year, and all future gains (assuming the person remains at the higher wage level in later years) would be gravy. This is a rarely-achieved return on investment – even investing twice that much would provide an attractive return.

This calculation only deals with the benefit to state government. The federal government would also benefit in some areas, but this would be offset by increased payments through the Earned Income Tax Credit, which rises as income rises from the minimum wage level. Regardless of the federal impact, it does not figure in return on investment decisions about state policy, because while Minnesotan are federal taxpayers, too, they can't recapture any savings in federal taxes or spending – the benefits are spread across all American taxpayers.

III Major Policy Options for Having More Families Able to Meet Basic Needs

A. Upgrading Workforce Education and Skills

1. Education
2. Skills

B. Supporting Businesses That Offer Good Jobs

1. Job-location incentives to individual companies
2. Subsidies in economically depressed areas
3. Direct employment subsidy
4. Support for high-wage industry clusters
5. Incentives for any firm investing in productivity

C. Mandated Wage Levels

1. Living wage requirement for firms with government contracts
2. State minimum wage

D. More Favorable Tax Treatment for Low-Wage Earners

1. Increasing the Minnesota Working Family Credit
2. Changing the phase-out rules

E. Strengthening Work Supports

1. Child care
2. Health care, transportation, housing

IV Upgrading Workforce Education and Skills

A. Education

There is a dramatic correlation between education level attained and income. A Minnesotan with a four-year college degree, on average, earns 2.5 times as much as a Minnesotan who has not completed high school. This "education premium" has grown steadily – in 1979, it was only 1.7 times.[9] That is because of changes in the mix of industries, and of jobs within industries – with more focus on technology, problem-solving, and managerial skills. This trend is expected to continue.

Minnesota is among the nation's leaders in high school completion rate –nearly 80% graduate in four years. This is widely viewed as a contributing factor to our strong economic performance – because business executives list a well-prepared workforce as a major factor in deciding where to locate or grow their business.[10] High school graduates on average earn about 40% more than non-graduates. In addition, Minnesota's high school graduates are far more likely to be pursuing postsecondary education a year later than graduates elsewhere. Minnesota also has a higher proportion of college graduates in the adult population. The only level at which we trail the national average is advanced degrees – 8.3% of Minnesotans have them, compared with 8.9% nationally.[11]

Our success, however, masks a serious problem. Our high school graduation rates for students of color are around 40%, which is below the national average. This creates an underclass with limited earning capacity.[12]

Several proposals have been suggested for increasing the high school completion rate for students of color. Among them are:

- Invest in raising the quality of K-12 teaching and providing better counseling and other support to students.
- Vouchers that permit disadvantaged students (or students at failing schools) to attend private or parochial schools by paying all or part of their tuition.
- Public investment in intensive pre-school education for disadvantaged 3- and 4-year-olds, to increase their readiness for kindergarten.

Among the options for increasing the number of two-year and four-year college graduates are:

- Lower tuition at public colleges.
- Increased scholarship assistance for high school graduates from low-income families.
- Increased mentorship of middle- and high-school students, during school and in after school and summer programs, on their postsecondary options.

B. Job Skills for People Already in the Workforce

Upgrading workforce skills has two positive impacts. For the individual, it offers him or her a chance to compete for higher-wage jobs. For the firm (and the state's economy), it increases the quality of the labor pool, thus attracting high-wage businesses to come or grow here –- studies show that workforce quality is a greater factor in business decisions about job location than taxes.

There is an enormous – almost bewildering – range of publicly funded programs for workforce development in Minnesota. The Governor's Workforce Development Council recently compiled an inventory that included 71 programs, administered by 11 state and five federal agencies, and more than $500 million of annual spending: $171 million state funding, $307 million federal, and $26 million local and match funds. About 500,000 Minnesotans a year visit one of the states' 53 Workforce Centers, a one-stop shop with information on all programs. The inventory includes a few programs focused primarily on education – such as the Adult Basic Education program, under which more than 11,000 people got high school equivalency diplomas. However, it does not include most of what the public spends on the University of Minnesota or the state college system, even though those institutions have a great impact on workforce development. In fact, a study done by Anton & Associates concluded that each $1 spent funding MnSCU produced $3.66 of productivity gains for Minnesota workers.[13]

There is no common measurement system for the state's workforce development programs. Some report results for job placements, wage levels, retention, and cost per placement. A handful use a return on investment measure. Many others report much less.

This briefing paper will look at three programs that do keep good records and appear to have promising results. They are for people already in the workforce – one for people who have just been laid off from good jobs and the other for low-wage people looking to upgrade their skills and get higher pay. The data are from 1998.

The Dislocated Worker Program, run by Minnesota Department of Trade and Development, served nearly 12,000 workers who were laid off from long-held jobs because of factors such as technological changes, investment decisions, and changes in consumption and competition. The program provides counseling, emergency support and job retraining. It successfully placed 76% of its participants, at an average hourly pay of $12.40 (about 82% of their previous wage), with a high 1-year and 3-year retention record. The program calculated its cost per placement as $4,360.[14]

The Job Skills Partnership, also run by DTED, is part of a recent nationwide trend, encouraged by the federal Workforce Investment Act, toward job-skill programs that focus on needs identified by employers who are hiring. MJSP awards grants of up to $400,000 to an education institution to work with at least one business partner, which matches the grant 1:1 with cash or in-kind contributions. The business and school develop cooperative training programs for new vacancies or for retraining current employees. In 1998, the program served 1,965 people, with a 91% placement rate, and a cost per placement of $715. The average hourly wage was $12.69.[15] (The governor's budget cuts $2.5 million from this program, and the House bill would double that, cutting $5 million.)

Minnesota Youthbuild, run by the Minnesota Department of Economic Security, assists at-risk youth ages 16-24 in making a transition to the work world. In 2002, it served 398 youths; 88% completed the program, and 91% of those got their GED. Four out five entered the workforce with jobs paying at least $10 an hour. State funding was $877,000, and the program calculates that net benefits to the state exceeded the funding within one year. (The governor's budget cuts $394,000 from Youthbuild's budget.)

In addition, many nonprofit organizations run workforce development programs, some of them with some public funding, many with funding from foundations, businesses and individuals. A full survey of this area is not possible in this report.

One well-known successful program is Twin Cities Rise!, which intensively trains minimum-wage workers for a year or more (providing a combination of soft and hard skills) and then places them in $10 an hour or better jobs, mostly in large Twin Cities corporations. TCR! reports that its training cost per graduate is $20,000, much higher than most programs, and it deals with only a few hundred people a year. However, its average graduate moves from an income of $5,606 to $23,768 – a 176% increase—and 96% of them were still in the job after six months, 85% after one year, and 79% after two years. TCR receives about 9% of is funding from governments, including money from the state of Minnesota, but is zeroed out in Gov. Pawlenty's budget proposal.[16]

In 2001, the McKnight Foundation invested $2 million in a Families Forward Initiative to help 10 nonprofit organizations assess and provide needed services to incumbent workers who need help advancing in the workplace. Their first progress report said the programs faced a lot of challenges as the economic environment shifted from a low-unemployment boom to an economic downturn.

A national effort, the Jobs Initiative, funded by the Annie E. Casey Foundation starting in 1995, had (by 2001) served 12,000 disadvantaged job-seekers, nearly half of them on public assistance, in six cities. About 5,500 were placed in jobs, paying at least $7 an hour. A year and a half after enrollment, 65% were working, compared to 25% when they enrolled. Comparing programs in the Casey initiative reveals that the length of training can make a major difference. One program, in Denver, focused on rapid job placement, usually within five weeks. It placed 40% of enrollees, at an average of $8 an hour, and had a low one-year retention rate – 34% – and low subsequent wage growth of about 7%. Philadelphia, on the other hand, ran a 61-week training program in manufacturing. Only one in three enrollees graduated, but they were placed at an average of $10.94 an hour, had a 78% one-year retention rate, and subsequent wage growth of 40%.

The Milwaukee Jobs Initiative program had placed 1,100 people, in jobs averaging $10.74 an hour, with a 12-month retention rate of 56%. They worked with the Wisconsin Regional Training Partnership, run by a board of business and union leaders in the Milwaukee area. An unusual feature of the program was employers typically selected training participants they would hire before they started training – fewer than 10% of participants dropped out of training.[17]

In short, these privately run job training programs have significant success – especially the ones involving more intensive, longer-term training – but they serve a small fraction of the people who could benefit from their services.

In addition to all the forms of workforce development mentioned so far, businesses themselves do substantial training of their own employees. There is no state data on how much they spend, but Ron Dreyer in a recent article extrapolated from federal data to produce an estimate of about $1.1 billion annually – almost as much as the Legislature appropriates for higher education. And unions are increasing their commitment to joint union-management training initiatives. Numerous studies show that training programs improve business's productivity.[18]

While more education and training clearly lead to higher wages, it does not follow that if everyone got more training, everyone could earn more. The job market includes many low-skill, low-wage jobs – only about ¼ of the vacancies in Minnesota require a college degree.

V. Supporting Businesses to Spur Job Creation

Economic development is supported by government largely on the basis that successful businesses create jobs. Some government policy is designed to address the business climate in general – such as lowering overall taxes on business or reducing regulatory red tape. Their connection to job growth and their cost-benefit results are difficult to quantify, and we will not discuss them in this report. Instead, we will focus on programs aimed more specifically at creating or retaining jobs in Minnesota.

A. <u>Job-Location Incentives or Subsidies to Individual Companies</u>

The State of Minnesota and local governments have numerous programs designed to support individual businesses and thereby create or retain jobs. The support can take the form of loans, grants, tax breaks and tax-increment-financing subsidies. Most of these programs support capital investment, in new or expanded plants or offices, for example. The programs require a commitment by the company to create new jobs at certain wage levels. Minnesota has one of the nation's better disclosure laws for keeping track of what effect these subsidies to business have on jobs.

In a 1999 report, Good Jobs First, a project of the Institute on Taxation and Economic Policy, analyzed more than 500 disclosure reports, involving more than $176 million in loans, grants and tax increment financing (TIF) subsidies. They found:

- 123 of the 550 deals provided assistance of more than $35,000 per job created, exceeding the federal economic development standard. Thirty-eight deals exceeded $100,000 per job.
- Two thirds of the deals involved jobs with wages 20% or more below local market levels for their industries. One sixth of the deals projected – and one-fourth actually pay – wages above existing averages.
- More than ¾ of the deals involved wages that would qualify a family of three for Medicaid.
- The low wages were surprising, because almost 2/3 of the subsidized jobs were in the high-wage manufacturing sector.
- There was no correlation between the size of the subsidy and the level of wages.
- TIF deals, done by local jurisdictions, were generally the worst offenders, both on wage levels and on the amount of job piracy involved. TIF subsidies, controlled by local governments, play a major role in moving jobs around the state as Minnesota corporations "play cities against one another or threaten to move for higher subsidies." Intrastate bidding wars, the report concluded, "are a much bigger dilemma for Minnesota cities than interstate competition."
- Some cities did a much better job than others at negotiating high wages for subsidies – especially Burnsville. The State Department of Trade and Economic Development also made many high-wage deals.
- Only one state loan program, the Minnesota Investment Fund, has high-wage requirements: $10 an hour in the metro area, $8 rural. Likewise, only MIF has a Cap on assistance per job: generally $5,000, and $7,500 for very high wage jobs, about $16 an hour.

The report analyzed only the disclosure reports in the state's database. Thus, it did not include subsidies through the relatively small Minnesota Enterprise Zone program, which does link the size of tax credits to the wage levels of jobs created, with higher credits for full-time jobs paying more than $7.20 an hour.[19]

Good Jobs First has not updated its study, so it is not clear if patterns have changed since 1999.

However, others, including the Minneapolis Federal Reserve's top researcher, Art Rolnick, have criticized economic development subsidies for individual firms, on the grounds that they just move jobs around – most often within the state – and that they give newcomers an advantage at the expense of existing businesses, even though most job creation comes from businesses already located here.

B. Subsidies Available in Depressed Regions

The most popular program in this arena is the Enterprise Zone, which provides tax breaks of various kinds to businesses in specific economically depressed geographical areas. Minnesota once had a bigger enterprise zone program, but what remains is a modest effort to retain jobs near the borders of neighboring states. Gov. Pawlenty has proposed a major new program, to create at least 10 new tax-free zones in greater Minnesota, which would exempt businesses from sales, income and property taxes for up to 12 years.

There are many enterprise zones in the U.S., and they have been around long enough to measure their impact. Opinion is divided. Some programs have produced data showing the creation of thousands of jobs, but critics contend that they cannot establish whether those jobs would not have been created without the incentives.

A review of zone programs in five states by researchers at Carnegie Mellon found that the zones "do not have a significant impact on local employment," regardless of the size of the incentives.[20] Earlier, an analysis of the zones nationwide by the Rockefeller Institute of Government at the State University of New York in Albany found that zones lure away jobs from other parts of the state and hurt state budgets, and that firms receiving the incentives don't always hire zone residents.[21]

A study by two Iowa University professors, Alan Peters and Peter Fisher, concluded that each job created in an enterprise zone costs states at least $40,000 in lost taxes. Generous programs like Michigan's and Pennsylvania's – models for Pawlenty's proposal – cost much more per job than $40,000, Peters said.[22]

C. <u>Direct Employment Subsidy</u>

The economic development incentives cited here – and others that exist in Minnesota – are capital-based, but are justified on the basis that they will create (or retain) jobs. An alternative is a direct employment subsidy – rewarding an employer with cash or tax credits per job created. Minnesota created such a program – the Minnesota Emergency Employment Development (MEED) program – in 1983, during the state's worst economy since the 1930s.

MEED began as a two-year $70 million program to create temporary jobs in government and nonprofit agencies as well as permanent jobs in the private sector. It offered employers up to $4/hr in wage subsidies and $1/hr in benefits for 26 weeks for hiring people who have been state residents for at least a month, are unemployed, and ineligible for unemployment insurance or workers comp. In its three-year life, according to an internal evaluation, it created 18,000 permanent private-sector jobs, at a net cost per permanent jobs of $3,100.

Today, there are two programs in place that provide federal tax credits to employers for hiring people from targeted disadvantaged groups. The Work Opportunity Tax Credit, which is set to expire at the end of 2003, provides an employer with up to a $2,400 credit for hiring people from eight targeted groups including welfare recipients, young food stamp recipients, veterans, and ex-felons. The Welfare-to-Work Tax Credit is more generous, offering up to $8,500 per long-term welfare recipient hired by Dec. 31, 2003. In Minnesota, federal tax credits worth $67 million were awarded to companies between Oct. 1996 (when the program began) and February, 2002. These two credits do not involve any Minnesota dollars. Even the administration of the program is covered by a federal grant.

D. High-Road Clusters

Another way to increase high-wage jobs is to encourage the development of industry clusters that pay well and that already have some strength in the state. These are usually associated with new technologies, because more traditional businesses (such as manufacturing and customer service centers) have experienced downward wage pressure as jobs have moved overseas.

This approach has been growing in importance, as subsidies for individual businesses have been increasingly questioned.

There are too many activities in this arena to capture in this brief report. Some examples:

- Gov. Pawlenty has shown great interest in building the state's biotech industry, convening a summit on the subject and announcing he will appoint fourteen scientific advisers. However, the governor said the state general fund has no money for the effort. Wisconsin has a state biotech investment fund of $317 million; Minnesota has none.
- The Biomedical Innovation and Commercialization Initiative (BICI) was created during the Ventura administration with $10 million seed money from the Legislature in 2001. It's a collaborative of the state, the University of Minnesota, the state's medical research institutions, and business and private investors designed to bridge the gap between academic research and the commercialization of new biomedical technologies.
- A Summit on Minnesota's Economy recommended, among other things, a knowledge-driven industry cluster strategy and cultivating a better-prepared workforce. No state action has been taken directly on the summit's proposals.

A related tactic is to support technology transfer, which should enhance productivity. Minnesota Technology Inc., a state-directed corporation funded by state, federal and private dollars, helps Minnesota businesses, especially in greater Minnesota, improve their productivity and competitiveness. The 3,000 companies that worked with MTI claimed $163 million of economic impact in 2001. MTI's budget was about $18 million for the biennium, almost 2/3 of it from the state. There was no state funding for the program in Gov. Pawlenty's proposed budget.

E. Incentives for Investing in Productivity

While many economic development dollars flow to specific companies for locating, expanding, staying, or directly creating new jobs, Minnesota also provides broader incentives to businesses in general in the form of tax preferences, known as tax expenditures.

About $6 billion in state and local taxes is imposed on businesses in Minnesota each year. Tax expenditures to encourage business investment total around $500 million, or 8% of the tax burden. Some of the expenditures just conform Minnesota taxes to federal ones, such as the accelerated depreciation rules. The largest single preference, however, is the exemption of capital equipment from the state sales tax, saving businesses $150 million a year. This is based on the premise that capital investment increases productivity, which in turn makes businesses more competitive and increases wages.

In a recent article, Richard Gebhart of the State Revenue Department analyzed effective tax rates and productivity by industry for 2001. He found that "it generally appears that industries with high rates of productivity growth tend to have lower effective tax rates in Minnesota." He cautioned that many factors influence productivity and that the research should be viewed as preliminary.[23]

VI Mandated Wage Levels

A. Living Wage Laws

The premise of a living wage law is that the federal minimum wage – currently $5.15 an hour – is way too low to support a family, and that companies that receive assistance from government should be required to pay a wage that can support a family. Minneapolis and St. Paul have living wage resolutions and Duluth has a living wage ordinance. They are among about 100 cities and counties to adopt such programs over the past decade.

In Minneapolis, the current living wage is $9.73 an hour, based on 110% of the federal poverty level for a family of four. (This is well below what's needed for a basic-needs budget.) Businesses benefiting from $100,000 or more in city assistance in one year must pay all employees at least this wage, and must set a goal that 60% of new jobs will be held by city residents.[24] St. Paul's resolution is similar, while Duluth's ordinance applies as well to firms receiving $25,000 in any kind of economic assistance from the city.

Opponents of living wage laws argued that living wage ordinances would increase unemployment and raise the cost of municipal government. However, academic studies of cities with living wage laws in effect have found no impact on the cost of city contracts and no unwillingness to bid, no reduction in staffing levels of affected firms, and no reduction in business investment in the cities. In fact, in Baltimore, the first city to enact such a law, some contractors later praised the ordinances for "leveling the playing field" by relieving pressure on employers to squeeze labor costs in order to win low-bid contracts.

The advantage of living wage laws is that they state publicly that decent private-sector wages are a goal of government and a societal good.

They have a major drawback, however: they affect only a tiny fraction of low-wage jobs. In 2001, the Minneapolis resolution affected 40 businesses, and less than 1,300 jobs.[25] Even the most aggressive living wage laws affect less than one percent of private-sector workers earning low wages in their city.

The State Legislature in 1996 passed a state living wage law, setting a minimum of $7.28 for companies receiving government subsidies, but it was vetoed by Governor Carlson.

B. State Minimum Wage

The federal minimum wage was raised in 1997 to $5.15 an hour. However, the real purchasing power of that wage is more than 30% lower than the purchasing power of the minimum wage in 1968, the peak year. A person working full time at the minimum wage today would be below the federal poverty line for a family of two, and more than 60% below the poverty line for a family of four with one full-time worker. And the poverty line, remember, is far lower than what is needed to live on a basic-needs budget.

Taking inflation into account, the federal minimum wage should be $7.49 to match its 1968 level. If instead it kept pace with productivity growth since 1968, it would be over $11. However, there is substantial opposition to moving it higher than $5.15.[26]

Opponents of raising the federal minimum wage argue that an increase will result in more unemployment, especially among teenagers.

However, the President's Council of Economic Advisers reported in 1999 that "the weight of the evidence suggests that modest increases in the minimum wage have had very little or no effect on employment."[27]

A study of the last minimum wage increase by the Economic Policy Institute found that it did not cause any job loss, even among teenagers, and 89% of small businesses said it did not affect their employment or hiring decisions.

And a 1999 survey of small businesses by the Levy Institute of Bard College found that only one firm in seven said that a $6.00 minimum wage would affect their overall hiring or employment decisions; one firm in three said they would be affected if the minimum were raised all the way to $7.25. The Levy analysis estimated a disemployment effect of 0.8% if the minimum went to $7.25.[28]

In Minnesota, which sets its minimum wage equal to the national minimum, an estimated 59,600 people, or 2.5% of wage-earners, earned $5.15 an hour or less in 2001.[29]

Since raising the federal minimum wage is so politically difficult, 10 states and the District of Columbia have adopted a state minimum wage higher than the nation's. (Minnesota is not one of them.) They are:

Delaware, D.C., Rhode Island: $6.15
Vermont, Maine: $6.25
Massachusetts, California: $6.75
Connecticut, Oregon: $6.90
Washington: $7.01
Alaska: $7.15[30]

These tend to be high-income states with above-average cost of living. A number of them raised their minimums as a result of a public referendum. Many of their laws call for the rates to keep rising automatically with inflation.

What impact have these state minimums had? Have they been more harmful than federal increases, because they put a state at a competitive disadvantage?

A study in 2000 of California's 1996 law, conducted by the California Budget Project, found that nearly 10% of Californians got pay raises – 80% of them were at least 20 years of age, more than half worked full time, and about a third were parents of minor children. In the three years after the law took effect, unemployment declined. Even traditionally low-wage fields like retail experienced continued job growth, and job growth was higher than average among teenagers, Latinos, and adults without high school degrees. Of course, there is no way to say whether unemployment would have dropped even more without the minimum wage increase during this period of strong economic growth.[31]

The Oregon Center for Public Policy found that Oregon's three-step increase to $6.50 an hour has had "substantial positive impacts on the earnings of low-wage workers … without significantly harming employment opportunities."[32]

The advantages of raising the minimum wage are that it would raise the income of many struggling families, and would create a multiplier affect as they spent their added dollars.

The disadvantages are that it would not have much impact on reaching the basic-needs level (more than $10 an hour), it could have a disemployment effect if the increase were dramatic, and its effect on families is sharply limited by the high effective marginal tax rate on people moving from $5.15 to $9 an hour (see discussion below).

VII Tax Treatment of Low-Income Families

In section V, we looked at what academics call employer subsidies. In Section VI, we looked at wage mandates. Now we turn to employee-based wage subsidies, where the wage-earner's pay is supplemented by the government.

A. Earned Income Tax Credits

The EITC was introduced in 1975 and expanded frequently since with the support of both Republicans and Democrats. Though much less visible than welfare or food stamps, EITC has become the largest poverty-fighting program in the nation, and scholars have praised its effectiveness at moving the families of working parents above the poverty line. Ronald Reagan called it "the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress." Unlike welfare, which flows to people who don't work, the EITC goes only to low-income working people as a supplement to their wages. Some features of the EITC:

- Benefits are much greater for parents of children than for adults without children, and greater for parents of two or more children than for parents of one.
- At the lowest wage levels, the credit rises as income rises. Eventually, however, the credit phases out.
- EITC is a refundable credit, so that a poor wage-earner who owes no taxes receives the entire credit as a check from the IRS.
- People whose income is low in a particular year but have significant investment income are not eligible for EITC. It is targeted at the working poor.

More than 200,000 Minnesota households claimed the EITC in 1997, for an average credit of $1,334.

Minnesota is one of 17 states to offer a state credit to supplement the EITC. Called the Working Family Credit (WFC), it was enacted in 1991, and modified in both 1998 and 1999. It is among the most generous of the state plans (Wisconsin's plan is more generous for families with three or more children, and a couple of other states have benefits similar to Minnesota's.) In 1991, it was set at 10% of the federal credit, which was raised to 15% in 1993 and was scheduled to rise to 25% in 1998. However, the formula was changed in 1998 to a percentage of income instead of a percentage of the federal credit. This made the WFC more complicated to calculate, but somewhat reduced the high marginal tax rates faced by workers as the federal credit phased down. Some features of the current WFC:

- For a family with two or more children, the credit is 8.8% of the first $9,720 of earnings, and 20% of earnings between $14,860 and $16,800, for a maximum credit of $1,243. The credit begins phasing down as income passes $17,890, and reaches zero at $31,145.
- The maximum credit for a family with one child is $634.
- About one fifth of recipients have no children, but they receive only about 2.5% of the benefits because their benefits are phased out at very low incomes.

- The WFC distributed about $80 million in 1998, nearly double the 1997 total because of the restructuring.

Statewide, about 8% of tax returns claim both credits. This is lower than the national average, because Minnesotans have higher incomes. Another 2% or so claimed the federal credit but neglected to claim the state credit. Nationwide, it is estimated that at least four out of five people who qualify for the federal credit do claim it.

One criticism of the EITC and WFC is that they pay out in a lump sum once a year, thus not helping struggling families meet current needs. There is an option for people to sign up through their employer to receive part of their expected credit in their regular paycheck, but only about 1% of eligible workers do so.

Minnesota spends about $80 million a year on WFC, and Minnesotans received about $240 million a year from the federal EITC.

B. Welfare and the Phase-out Rules

Minnesota's welfare plan, conforming to the 1996 change in federal policy, is now focused on moving people from welfare to work. It continues to pay the most to families with either no wage-earner or no full-time wage-earner, but it limits how long they can collect and it supports working parents at a reduced rate until their household reaches about 120% of the poverty level. So, as income rises, MFIP payments decline. Minnesota spends $114 million a year on MFIP, with the feds kicking in $209 million.

According to a Minnesota House research report (Jan. 2000), "the WFC and EITC combine with other features of the income tax, the payroll tax, and the state's welfare program to produce high marginal tax rates for individuals in some income ranges." The driver of this high effective tax rate is the sharp decline in the MFIP or state welfare grant as income rises.

The change in the WFC in 1998 was designed to alleviate this disincentive to earn more. But the House's data show that its effect on the problem was very small. Before the restructuring, a wage increase from $6 to $7 an hour would have increased earnings $2,080, but increased available resources of a single parent with two children by only $149. This represents a marginal effective tax rate of 93%. After the restructuring, the family would keep $237 of the $2,080, for a marginal tax rate of 89%. In other words, the working parent gets only 11 cents out of every extra dollar earned.[33]

The same is true for moving from $7 to $8. The single parent with two children – under the restructured law – keeps nine cents out of every extra dollar earned. (Under the old law, she or he would actually have less money: the marginal tax was over 100%.)

The situation improves for moving from $8 to $9, because there is not much left of the MFIP grant to lose. Under today's formula, the single parent keeps 49% of the increase. However, this is still a higher marginal tax rate than wealthy people pay on added earnings.

Here is another way to look at the data:

If a single mother with two kids working full-time for the minimum wage of $5.15 got a job at $8 an hour (more than a 50% raise), her earnings would increase $5,928. But her available resources would increase only $957.

Change in the phase-out rules could create more incentive for people to want to move up the wage ladder.

VIII Strengthening Work Supports

A. Child Care

The lack of affordable child care is a major barrier for low-income workers with young children. Based on Jobs Now data, the average cost of child care for one 2-year-old child in the Twin Cities metro area is $540 per month, or about 20% of the basic-needs budget for a single parent. For two children, one age 2 and the other a 6-year-old being cared for after school, it's $773 -- or 23% of the basic-needs budget of a single parent. This adds more than $5 an hour to the wage required for this parent to support two children.[34]

Minnesota has a sliding-fee subsidy program to help low-income parents pay for child care. In Hennepin County, for example, a mother with two children earning the $3,373 a month required to meet a basic-needs budget would be asked to pay only $550 a month, more than $200 less than the average cost. And if she were earning $200 less per month, her child care cost would go down about $100. If she were earning only $2,075 a month, she would pay only $80. Unless she couldn't get the subsidy, because she was on the waiting list, since funds are limited.

Minnesota spends $23 million on sliding fee child care, and the U.S. kicks in $62 million.

The Minnesota House Republican bill, in order to restore more dollars for programs for seniors, reduces the current funding for the sliding fee program by 50%. The cutoff for participation would drop from $42,000 to about $37,500, eliminating about 1,100 families, and a family of three earning $25,000 would have to pay $255 a month instead of $80.

There are two other child care subsidies in Minnesota: The state spends $40 million for child care for about 9,000 families on welfare, two-thirds of which have a wage-earner. The feds add $30 million. And families that begin earning too much for welfare can receive 12 months of transition child care, at a cost of $12 million from the state and $9 million from the U.S. to serve nearly 3,000 families.

B. Housing, Health Care, Transportation

These three items account for nearly half the budget of struggling families, and represent significant barriers to succeeding in the workplace. This report will not address these complex areas, but clearly lowering the cost and/or increasing access would contribute to the goal of having more families able to support their families at a basic-needs level.

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