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Why a 'Living Wage' Doesn't Kill Poverty

EXAMINING CANADA'S NEWEST SOCIAL POLICY

By Peter Shawn Taylor

About the Author

Peter Shawn Taylor is currently Editor at Large of *Maclean's* magazine. He earned a Master's degree in Economics from the University of Alberta in 1989; and was senior analyst for the Alberta Liberal Caucus in the early 1990s under Liberal Leader Laurence Decore. Since then he has worked extensively in journalism. He has been a staff member of *Alberta Report, Canadian Business* and the *National Post,* where he was a founding member of the editorial board in 1998, as well as *Maclean's*. In addition, he has written widely for publications including *Reader's Digest, Saturday Night, Equinox, MoneySense, Canadian Geographic, Prospect, Globe and Mail, Vancouver Sun* and *National Post Business*. He has given presentations and is a frequent media commentator on public policy issues including daycare, family taxation and poverty.

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MB: 203-2727 Portage Avenue,
Winnipeg, Manitoba Canada R3J 0R2
Tel: 204 957-1567 Fax: 204 957-1570

SK: 2353 McIntyre Street,
Regina, Saskatchewan Canada S4P 2S3
Tel: 306 352-2915 Fax: 306 352-2938

AB: Ste. 2000 – 444 5th Avenue SW
Calgary, Alberta Canada T2P 2T8
Tel: (403) 230-2435

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Executive Summary

- A living wage involves a municipally-set minimum wage rate that applies to all city employees and, in many cases, to employees of businesses that contract with the city. This wage rate is set by a variety of arbitrary methods.
- While largely unknown in Canada, the living wage has become a popular social policy tool across much of the United States. It is currently being proposed in Calgary and in the Regional Municipality of Waterloo in Ontario.
- Despite its popularity with social policy groups and unions, the effectiveness of a living wage is in considerable doubt. While those directly receiving a living wage see their incomes rise, this group typically represents a very small proportion of the total labour force. A living wage does not have any direct effect on the broader working poor population.
- The living wage raises issues of appropriate targeting. There is no guarantee that the recipients of a living wage are in poverty to begin with. In the US it has been estimated that only one-quarter of living wage earners were living in households below the poverty line. In Calgary, it appears many of the proposed recipients are summer students and casual workers.
- While the benefits appear small and poorly targeted, living wages may entail considerable hidden costs and unintended consequences. Most direct expenses appear to be borne by the private sector. This raises questions of fairness. Living wages may also lead to job losses among low-skilled workers. And it could encourage workers to stay in low-skilled jobs rather than upgrade their skills or education.
- While the direct costs to municipal taxpayers appear modest, there is evidence of substantial indirect costs. Paying low skilled municipal workers higher wages can lead to an inflationary cascade effect as higher skilled workers demand compensatory raises. It has also been proposed that living wage policies will lead to greater union control of municipal services, causing less contracting-out and higher municipal payroll costs over time.
- A living wage fails all the standard criteria for evaluating new social policies: it provides a low social return, it is inefficient, unfair and creates many negative incentive effects. Providing small benefits to a limited group of individuals who may or may not be in poverty is unlikely to solve the problems facing the working poor.
- If the policy objective is to help the working poor, federal or provincial welfare-to-work transition programs are much better targeted and more effective. These programs are also more likely to enjoy broad public support.

Living Wage: What is it?

After decades of focusing poverty reduction policies on the unemployed, the working poor have recently been receiving more attention from governments of all levels. This includes the federal Working Income Tax Benefit as well as provincial welfare-to-work transition programs such as Manitoba's Rewarding Work. At the municipal level, some cities in Canada are considering the living wage, as pioneered in the United States and Britain, as a further means to help the working poor.

A living wage is based on the concept that full-time wages ought to provide a comfortable standard of living for a worker and his or her family. The appropriate living wage rate may be based on the local cost-of-living, relative income indicators or some other calculation. In this way it is distinct from traditional wage-setting practices in which employers offer wage rates based on the expected productivity of a particular job and the willingness of potential employees to accept those wages.

A living wage also differs from minimum wage laws in which state, provincial or federal governments set base-line wage rates below which no employee can be paid. Living wage rates are set by municipal governments, which typically lack the authority to impose economy-wide labour standards. As a result, these rates apply only to municipal employees and, in some cases, employees who work for businesses or organizations contracting with or receiving grants from the municipal government. In this way, a living wage becomes a requirement for doing business with the local government.

Under a living wage regime, municipal workers and employees of businesses that contract with the municipal government typically receive wages that are higher than those paid to workers doing similar work outside the municipal sphere. Supporters of the living wage point to the direct benefit of higher wages as evidence of its success in fighting poverty. They further argue this policy provides ancillary benefits to the rest of the work force, as well as the business community. These benefits are subject to considerable debate. The scope and size of costs imposed by living wage policies are also contentious issues.

"Living wage rates are set by municipal governments, which typically lack the authority to impose economy-wide labour standards."

Living Wage:
History

Baltimore pioneered the living wage concept in 1994, with implementation beginning in 1996.[1] The idea was promoted by religious and labour organizations as part of a series of federal, state and local social policies designed to reverse severe economic distress and depopulation in the blighted urban core of Baltimore.

Since then, the concept has been heavily promoted by the lobby group ACORN (Association of Community Organizations for Reform Now) and has successfully spread across the US.[2] Following Baltimore, it was rapidly proposed and accepted in cities including New York City, San Francisco, Detroit, Boston, Los Angeles, Tucson and Portland. Approximately 140 US cities now have a living wage ordinance. Implementation has not been without controversy, however. While unions are frequent advocates for a living wage, the move has been strongly opposed by local Chambers of Commerce in many cities. Some states have even launched pre-emptive laws that forbid municipalities from enacting living wage laws, something Canadian provinces may wish to consider given the apparent deficiencies in the living wage approach to combating poverty.[3]

Living wage policies have been promoted in Great Britain since 2001 by the activist group London Citizens. In 2005 London Mayor Ken Livingstone ran for re-election promising to implement a living wage. He subsequently oversaw the adoption of a London Living Wage by the Greater London Authority, the regional government. While Livingstone was defeated in 2008, his successor Boris Johnson pledged to continue this policy. Following aggressive union efforts, including strikes and pressure campaigns, some private sector and public sector employers have also adopted the living wage. These include accounting firms, universities, hospitals and the 2012 Olympic committee.[4]

Approximately 140 US cities now have a living wage ordinance...

...a London Living Wage by the Greater London Authority...

Living Wage:
Canadian experience

No Canadian city has adopted a living wage to date. However, it has been debated and proposed in Calgary, Alberta and the Regional Municipality of Waterloo in Ontario. A detailed proposal has been drafted for approval by Calgary city council in March 2009. The concept has also been discussed in Hamilton, Peterborough and Pelham, Ontario.

The living wage is heavily promoted by Canadian social policy advocacy groups including the Canadian Centre for Policy Alternatives, Campaign 2000, Community Social Planning Council of Victoria and Vibrant Communities Calgary plus numerous unions including the Hospital Employees Union of British Columbia, Canadian Union of Public Employees, Toronto & York Region Labour Council and the Canadian Labour Congress.

*“**No Canadian city** has adopted a living wage to date.”*

Living Wage: Calculations

Crucial to a living wage policy is the calculation of the appropriate wage. Since this wage is not set by the traditional bid-and-ask system of the market economy, it must be produced by some other means. As there is no accepted method or common definition for a living wage, this calculation can be highly political and arbitrary. Regardless of the calculation method, living wage rates tend to be 50 percent or more above existing minimum wages.

In Baltimore, the living wage was initially set at US$6.10 per hour in 1996, rising to US$7.70 in 1999. This was based on the observation that a sole provider for a family of four would need to work 40 hours per week for 52 weeks at US$7.70 per hour in order to meet the then-federal poverty guideline of approximately US$16,000. This rate has been indexed for inflation and is currently US$9.93 per hour.[5]

> **Regardless of the calculation method,** ***living wage rates tend to be 50 percent or more above existing minimum wages.***

Other US cities have used varying methods to determine their living wage, although frequently with reference to the federal poverty rate. Current figures range from US$9.00 to US$12.00 per hour. Some cities include health care benefits, paid vacation and mandatory training as additional requirements of the living wage.[6]

Outside the US, advocates tend to argue that the poverty line is an insufficient standard for a living wage and that it should instead raise recipients substantially above basic poverty levels.

In London, England, the Greater London Authority has a complicated multi-stage method of calculation. It first develops a market-basket expenditure list of basic necessities for four sample families. It converts these four calculations into one weighted average poverty-wage level of £6.25 ($11.10 per hour). Then it separately calculates the wage rate necessary to achieve 60 percent of the median income. This figure is currently £6.70 ($11.90). These two numbers are averaged together. Finally this blended figure is increased by an arbitrary 15 percent, what is called a "margin against poverty," to achieve the final result of a £7.45 ($13.25) living wage rate.[7]

The Canadian Centre for Policy Alternatives has published several calculations for major Canadian cities based on its own market-basket expenditure calculations. These calculations are not based on existing poverty levels, but on the CCPA's determination of a "decent standard of living."[8]

For Toronto, the CCPA calculates a living wage of $16.60 per hour based on a two-parent, two-child family in which both parents work full-time for 37.5 hours per week. Included in this basket is an annual two-week cottage rental vacation and one dinner and movie outing per month for the family. It also covers ownership and maintenance costs for a four-year old Chevrolet Impala, a mid-sized sedan. (The average car in Canada is 7.6 years old.[9]) A separate living wage was calculated for a Toronto single mother with no access to child care subsidies. This is $22.45 per hour.

Another report from the CCPA produced a living wage of $16.74 for Vancouver and $16.39 for Victoria.[10] These figures do not include a cottage vacation and are based on a 35 hour work week. Both provide for the ownership of a five-year old Chevrolet Cavalier, a compact car. This report also indicates that single mothers should receive a higher living wage, but did not specify the amount.

The Region of Waterloo staff report adopts a market-basket expenditure approach to calculating its local living wage. It is based on a single female living alone, yielding a living wage of $13.62. Her basket includes various recreational pursuits such as fitness lessons, pool visits, movie tickets and restaurant meals, but no car or vacation.[11]

The City of Calgary staff report recommends a living wage of $13.25 as calculated by the non-profit group Vibrant Communities Calgary. Rather than a market-basket expenditure estimate, this figure is derived from Statistics Canada's 2005 Low Income Cut-Off figure of $20,778 for a single person living in a Canadian city with a population of 500,000 or more. Working 35 hours per week, LICO yields a wage rate of $11.41 in order to bring the individual up to the unofficial poverty line. However this figure was considered to be too low by the 'living wage action team' at Vibrant Communities Calgary, and they boosted it by 16 percent to $13.25.[12]

***Calculations are not based on existing poverty levels,* but on the CCPA's determination of a "decent standard of living."**

Living Wage: Benefits

There is considerable controversy regarding the actual impact of a living wage. As might be expected, the living wage has been most closely examined in the US where, after more than a decade of experience, it is still the subject of vigorous debate. Several similarly-named think tanks frequently engage in dueling reports. For example, the Economic Policy Institute is a pro-living wage organization while the Employment Policies Institute is opposed.

With respect to benefits, there is general agreement that those individual workers directly affected by living wage laws receive a distinct gain, although the size of this group and their net benefits may appear surprisingly small. In Baltimore, a 1999 follow-up study found that only 1,495 local employees had gained from the living wage.[13] Of these, 60 percent were school bus drivers and school bus aides, most of whom worked part-time and were still below the poverty line even after receiving a living wage. In 1999 the work force in the Greater Baltimore area was 1.2 million.[14] This reflects a general rule of thumb that observes living wage policies typically affect only one percent of an area's total work force.

In Calgary, the current proposal for a living wage ordinance would have very limited impact. As all full-time employees already earn in excess of $13.25 per hour, the only 680 staff members would be affected by the living wage, mostly casual staff in the recreation department including youth leaders, babysitters and concession stand attendants. Even if the living wage was expanded to include contractors with the city, the average hourly wage in all service contract areas required by the city is currently above $13.25.[15] Thus even a broader living wage policy would have limited effectiveness in raising municipal-related wages across the city.

In Waterloo Region, the initial staff report suggests that no full-time employees would be affected by a living wage as they all earn more than $13.62. Waterloo has recommended excluding summer casual staff from its living wage policy.[16]

Advocates claim that "the living wage is a crucial tool in the effort to end poverty."[17] If so, the small size of the groups directly affected by the policies gives reason for pause. Mandating a living wage for employees already earning wages above that rate is obviously a symbolic effort devoid of practical effect. Mandating it for employees of private sector firms doing business with the city may bring benefits to those directly affected depending on existing wage rates.

Some supporters argue that a living wage has broader impacts by pushing other employers not covered by the living wage to raise their pay rates to match the better paying jobs within the municipal sector. There is limited evidence this occurs.

One major US study, by economists Scott Adams and David Neumark, has shown that a living wage may create spill-over benefits to the broader low wage sector.[18] This finding has been sharply challenged by the Economic Policy Institute (the pro-living wage think tank) because of the related costs it revealed. More on this in the next section.

Living Wage: Costs

The living wage is often presented by its advocates as a policy that creates substantial social benefits at modest or insignificant cost to taxpayers. But this claim of getting 'something for nothing' bears deeper consideration. It may be the case that many costs have been overlooked or are hidden.

Higher wages for municipal employees must necessarily be borne by city taxpayers. Where living wages affect the employees of businesses contracting with the city, these costs may be distributed between taxpayers and employers.

According to US research, largely from the pro-living wage organization Economic Policy Institute, the direct cost to taxpayers appears quite modest. Since most city employees already receive wages above the living wage level, applying a living wage to them is likely to have little impact on the city wage bill.

A larger result might be expected in the contracting-out sector. In Baltimore the increase in city contracting costs due to the living wage was estimated at 1.2 percent of total contracting costs, or what was considered an "insignificant" amount after inflation.[19] This was based on comparing 26 identical contracts before and after the living wage.[20] Evidence from other US cities further suggests rather modest costs imposed on municipal budgets due to a living wage.[21/22]

If cities are not paying the costs of higher living wages, this means it must be shouldered by the private sector. In Detroit the extra costs to business contracting with the city due to a living wage were estimated to average approximately 2.5 percent of the total contract.[23] Research on Boston's living wage has shown that nearly 40 percent of private sector firms affected by the living wage saw their profits reduced.[24] Advocates claim these extra costs and reduced profits are partially ameliorated by higher productivity and reduced absenteeism among workers receiving higher living wages.[25] It remains the case, however, that living wages reduce net profits among businesses affected.

Consumers may also face higher prices. When a living wage was imposed on San Francisco International Airport employers in 1999, costs rose by 0.7 percent of annual airline revenues, which represented an average of US$1.42 per passenger.[26]

It is also possible that mandating high wages for low-income workers will cause employers to reduce the number of workers they employ. The Adams and Neumark study previously mentioned estimated that in addition to raising average wages at the low-end of the employment range, it would also lead to a statistically significant reduction in employment among low-skill workers.[27] In this way, living wages may entail a trade-off in which the advantage of higher wages for a small number of the working poor compete against the disadvantages of reducing employment opportunities for others. This is similar to arguments made about increases to the minimum wage.

Living Wage: Problems

It is necessary to judge all potential public policies against the standard criteria of total social return, efficiency, fairness and incentive effects. And by these measures, a living wage appears to be a poor policy choice.

First, the concrete benefit of a living wage is extremely modest. A policy that directly affects about one percent of the working population is not particularly convincing as a comprehensive anti-poverty policy. While some individuals may see large gains, the total benefit to society appears quite small.

Second, is it efficient or properly targeted? There are strong concerns about whether those affected by a living wage are actually in poverty to begin with. US research is ambiguous on this question. Some small demographic surveys have found that living wage recipients are predominately black and female.[28] Due to data issues, however, there is no conclusive evidence that these recipients are actually below the poverty threshold. A larger econometric study of US income data found that three-quarters of all living wage recipients were likely to live in households above the poverty level.[29]

> ***There are strong concerns about whether those affected by a living wage are actually in poverty to begin with.***

Almost half of living wage recipients were expected to live in households with incomes twice the poverty line. This is due to the presence of multiple wage-earners in the same household.

Calgary's new proposal lacks assurances of appropriate targeting. Most City of Calgary jobs affected by the living wage will be casual summer positions typically filled by students. These workers may or may not be living in poverty. Some may in fact be living at home in considerable affluence. Most are unlikely to be the sole supporters of their family.

Additionally, it makes little sense to target anti-poverty programs towards workers in the public sector. Public sector employees already enjoy incomes substantially above those in the private sector. Recent research from the Canadian Federation of Independent Business found that once wages plus paid and unpaid benefits were considered, municipal employees enjoyed a compensation advantage of 36 percent over the private sector across comparable occupations.[30] This covers low-skilled jobs including clerks, janitors and outdoor labourers – those most likely to be affected by a living wage.

The evidence suggests the bulk of the direct costs associated with a living wage will be borne by the private sector in the form of lower profits. This raises questions of fairness. Is it appropriate to expect the private sector to shoulder the burden of reducing poverty among a small, select group of occupations? As not all employers will be required to contribute equally to the costs of a living wage, the policy thus acts as a tax on firms that do business with the city.

It is also possible that living wage policies will act as a disincen-tive for firms to locate in a particular city by raising the cost of labour. There is no conclusive evidence on this, for or against.

A living wage may entail additional and unexpected costs due to a variety of problematic incentive effects. US experience suggests that raising wage rates for the working poor can create knock-on effects for taxpayers as other workers seek to re-establish pre-existing wage differentials. Raises for school bus aides in Baltimore, for instance, led to school bus drivers demanding higher wages as well.[31] This can create an inflationary cascade effect of higher wages throughout the municipal sector.

As described previously, unions have been strong supporters of living wage policies in the US, UK and Canada. Economist Neumark suggests that this is because a living wage policy reduces the appeal of contracting-out municipal services to the private sector by narrowing the gap between costs in the private sector and public sector.[32] If a living wage reduces competition for municipal contracts, this could result in greater union control over service delivery and increases in municipal taxes over time.

It is also the case that raising the minimum wage for certain jobs could distort the labour market. If living wages boost the pay for certain municipal jobs, low-skilled workers may decide to queue for those jobs instead of going back to school to upgrade their education. This could create a high-wage, low-skill ghetto of jobs. According to a report on the Waterloo Region proposal, a living wage can "have many distortionary effects, potentially reducing skill levels at the lower end of the income distribution and creating longer periods of unemployment among low skilled workers."[33] There is also the possibility of favouritism in the awarding of now-desirable municipal jobs. Finally, there may be additional negative incentive effects on family formation. Recall suggestions from the CCPA that living wage rates should vary with family and marital status. A single mother would thus receive a higher wage than a married mother or father doing exactly the same job. Implementing this sort of living wage differential would appear to present an obvious case of work-place discrimination and may well be unconstitutional. It could also create unintended negative consequences, such as an incentive to avoid marriage.

In general anti-poverty policies will be most effective – and mostly likely to enjoy broad public support – when they are well-defined and highly-targeted to those most in need. The ambiguity regarding the recipients of the living wage and the benefits they receive suggest that the living wage would not be a significant factor in reducing poverty in Canada. And its flaws are likely to create strong objections among local taxpayers and businesses.

> ***A living wage may entail additional and unexpected costs due to a variety of problematic incentive effects.***

Living Wage: Alternatives

Several existing policies already provide important and necessary support to low-income working Canadians while avoiding the problems and controversies associated with a living wage.

At the federal level, the preferred policy tool is the Working Income Tax Benefit. According to the 2009 Budget, WITB is scheduled to provide a refundable tax credit of up to $1,680 per year to families below $25,700 in annual income.[34] For individuals, the maximum benefit is $925 and the top income threshold of $16,667. The amount is reduced as income reaches the maximum levels. This program has the advantage of reaching all low-income workers. It does not discriminate based on job type or employer and is neutral with respect to private sector employment decisions and the profitability of businesses.

At the provincial level, wage supplements and the provision of benefits tied to work force attachment achieve similar results. Many provinces have implemented such programs in the past decade or so, including Ontario, Alberta and British Columbia. Manitoba's Rewarding Work program is a recent example of these provincial efforts to de-link certain benefits from the welfare system and smooth the transition to work.[35] Rewarding Work provides exemptions for earned income to encourage welfare recipients to find employment, establishes wage supplements for employers hiring people on income assistance and extends benefits such as child care subsidies and bus passes to the working poor. This is in addition to existing provincial policies covering social housing, health care and education for low-income residents.

Because these sorts of programs are based on income tax returns and other application data, they are highly targeted and thus quite effective in reaching the working poor. They are also more likely to engender broad public approval as compared to a selective and ambiguous living wage policy.

The desire of city governments to create their own poverty reduction policies may be commendable, but a living wage is clearly not the best available tool to fight poverty.

> ***These programs are highly targeted and thus quite effective...***

Living Wage:
Questions

Municipal politicians and local taxpayers in cities considering a living wage policy may wish to ask the following questions:

Are the intended beneficiaries of a living wage in poverty?
Is a living wage an appropriate policy for reducing poverty and helping the working poor? Anti-poverty policies work best when they are targeted to those most in need.

Is it equitable to mandate a benefit for a very small percentage of the working poor? Living wage policies typically cover only one percent of the working population. How does raising the wages by 50 percent of a tiny proportion of the labour market affect the rest of the work force? Could this lead to favouritism in awarding municipal jobs?

How should the living wage be calculated? Should it be based on relative income measures, federal poverty lines, arbitrary market-basket expenditures or a combination of all of the above? Is it appropriate to have city bureaucrats set local wage rates? Is it appropriate to add correction factors simply to make the living wage larger?

Is it appropriate to require the private sector to cover the bulk of the costs associated with a living wage? Will this lead to a reduction in private sector investment in a living wage city?

Should wage rates be based on family characteristics? The CCPA calculates living wages that vary with family size and marital status. Yet paying different rates to people doing the same job for these reasons would appear to present an obvious case of workplace discrimination and may well be unconstitutional.

Are there unintended consequences of mandating living wage rates?
Will it create an inflationary cascade of higher wages throughout the municipal sector? Will it encourage low-skilled workers to remain in low-skilled jobs?

Will a living wage reduce the attractiveness of contracting-out and lead to larger municipal payrolls and higher municipal taxes? Is union support for a living wage based on the prospect of monopoly provision of municipal services?

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WHICH BEST HELPS THE POOR?
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A CONVERSATION WITH DAVID BEITO
Author of *From Mutual Aid to the Welfare State: Fraternal Societies and Social Services, 1890-1967,* July 2000

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