Consumer and Community Impacts of Hazard Pay Mandates

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Brad Williams joined Capitol Matrix Consulting in 2011, after having served in various positions in state government for 33 years. Mr. Williams served for over a decade as the chief economist for the Legislative Analyst's Office, where he was considered one of the state's top experts on the tax system, the California economy, and government revenues. He was recognized by the Wall Street Journal as the most accurate forecaster of the California economy in the 1990s, and has authored numerous studies related to taxation and the economic impacts of policy proposals. Immediately prior to joining CMC, Mr. Williams served as a consultant to the Assembly Appropriations Committee, where he advised leadership of the majority party on proposed legislation relating to taxation, local government, labor, and banking.

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Executive Summary

Hazard-pay mandates passed in the City of Long Beach and under consideration in the City of Los Angeles and in other local jurisdictions would raise pay for grocery workers by as much as $5.00 per hour. Since the average pay for grocery workers in California is currently about $18.00 per hour, a $5.00 increase would raise store labor costs by 28 percent, and have major negative impacts on grocery stores, their employees and their customers. Specifically:

- Average profit margins in the grocery industry were 1.4% in 2019, with a significant number of stores operating with net losses. While profits increased temporarily to 2.2% during early to mid 2020, quarterly data indicates that profit margins were subsiding to historical levels as 2020 drew to a close.

- Wage-related labor expenses account for about 16 percent of total sales in the grocery industry. As a result, a 28 percent increase in wages would boost overall costs 4.5 percent under the City of Los Angeles proposal of $5.00 per hour. *This increase would be twice the size of the 2020 industry profit margin and three times historical grocery profit margins.*

- In order to survive such an increase, grocers would need to raise prices to consumers and/or find substantial offsetting cuts to their controllable operating expenses, which would mean workforce reductions. As an illustration of the potential magnitude of each of these impacts, we considered two extremes:

  1) All of the higher wage costs (assuming the $5.00/hour proposal) are passed through to consumers in the form of higher retail prices:

     - This would result in a $400 per year increase in grocery costs for a typical family of four, an increase of 4.5 percent.

     - If implemented in the City of Los Angeles, its residents would pay $450 million more for groceries over a year.

     - The increase would hit low- and moderate-income families hard, particularly those struggling with job losses and income reductions due to COVID-19.

     - If implemented statewide, additional grocery costs would be $4.5 billion per year in California.

  2) Retail prices to consumers are not raised and all the additional costs are offset through a reduction in store expenses:

     - Given that labor costs are by far the largest controllable expense for stores, it is highly likely that the wage mandates will translate into fewer store hours, fewer employee hours, and fewer jobs.

       - For a store with 50 full-time equivalent employees, it would take a reduction of 11 employees to offset the increased wage costs, or a 22% decrease in staff.

       - If the mandate were imposed statewide at $5.00 per hour, the job loss would be 66,000 workers.

- If imposed in the City of Los Angeles, the job loss would be 7,000 workers.

- And in the City of Long Beach, the job impact of its $4.00 per hour mandate would be 775 jobs.

- Stores could alternatively avoid job reductions by cutting hours worked by 22 percent.

- For the significant share of stores already operating with net losses, a massive government-mandated wage increase would likely result in store closures, thereby expanding the number of "food deserts" (i.e. communities with no fresh-food options).

Introduction

The Long Beach City Council has passed an ordinance that mandates grocers to provide a $4.00 per hour pay increase – "hazard pay" – to grocery workers. The mandate expires in 120 days. Two members of the Los Angeles City have introduced a similar measure for a $5.00 per hour increase for companies that employ more than 300 workers nationwide. Grocery workers in California currently earn about $18.00 per hour.[1] Therefore, the Los Angeles proposal would increase average hourly pay to $23.00 per hour, an increase of 28 percent. Several other cities in California have discussed $5.00/hour proposals similar to Los Angeles.

This report focuses on the impact of hazard pay mandates on grocery store profitability and on the sustainability of an industry with traditionally low profit margins. It also assesses the potential impact of the proposed wage increases on consumers, especially lower-income consumers (a cohort already hit hard by the COVID lockdowns and business closures).

Background — Grocery is a Low-Margin, High-Labor Cost Business

The grocery business is a high-volume, low-margin industry. According to an annual database of public companies maintained by Professor Damodaran of New York University (NYU),[2] net profit margins as a percent of sales in the grocery industry are among the lowest of any major sector of the economy. Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) averaged 4.6 percent of sales in 2019, and the net profit margin (which accounts for other unavoidable expenses such as rent and depreciation) was just 1.4 percent during the year. This compares to the non-financial, economy-wide average of 16.6 percent for EBITDA and 6.4 percent for the net profit margin. The NYU estimate for public companies in the grocery industry is similar to the 1.1 percent margin reported by the Independent Grocers Association for the same year.[3]

COVID-19 temporarily boosted profits

In the beginning of the COVID-19 pandemic, sales and profit margins spiked as people stocked up on household items and shifted spending from eating establishments to food at home. According to data compiled by NYU, net profit margins in the grocery industry increased to 2.2 percent in early to mid 2020.[4] Although representing a substantial year-to-year increase in profits, the 2.2 percent margin remains quite small relative to most other industries. This implies that even with the historically high rates of profits in 2020, there is little financial room to absorb a major wage increase.

[1] $18.00 per hour is consistent with the responses we received to our informal survey. It is also consistent with published contract agreements we reviewed. See, for example, the "Retail Food, Meat, Bakery, Candy and General Merchandise Agreement, March 4, 2019 - March 6, 2022 between UFCW Union Locals 135, 324, 770,1167,1428,1442 & 8 - GS and Ralphs Grocery Company." In this contract, hourly pay rates starting March 2, 2021 for food clerks range from $14.40 per hour (for first 1,000 hours) up to $22.00 per hour (for workers with more than 9,800 hours), The department head is paid $23.00 per hour. Meat cutter pay rates range from $14.20 (for the first six months) to $23.28 per hour (for those with more than 2 years on the job). The department manager is paid $24.78 per hour. https://ufcw770.org/wp-content/uploads/2020/08/Ralphs-Contract-2020.pdf

[2] Source: Professor Aswath Damodaran, Stern School of Business, New York University. http://pages.stern.nyu.edu/~adamodar/

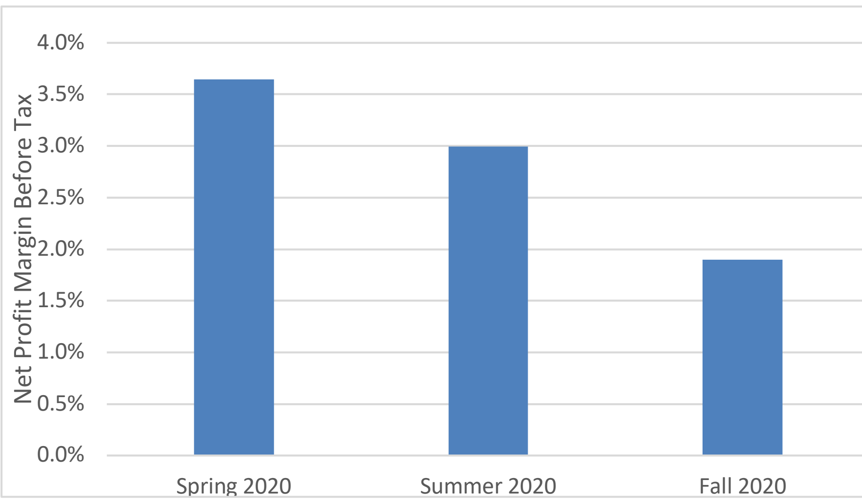
[3] Source: "2020 Independent Grocer Financial Survey." Sponsored by the National Grocer's Association and FMS Solutions Holding, LLC

[4] Supra 2.

But the increases are subsiding

Moreover, quarterly data indicates that the sales and profit increases experienced in early 2020 were transitory and were settling back toward pre-COVID trends as 2020 drew to a close. This quarterly trend is evident in quarterly financial reports filed by California's two largest publicly traded companies in the grocery business: The Kroger Company (which includes Ralphs, Food for Less, and Fred Meyers, among others) and Albertsons (which includes Safeway, Albertsons, and Vons, among others). Figure 1 shows that the average profit margin for these two companies was 3.6 percent of sales in the Spring of 2020, declining to 1.9 percent by the fourth quarter of the year.[5] Monthly sales data contained in the 2020 Independent Grocer's Financial Survey showed a similar pattern, with year-over-year sales peaking at 68 percent in mid-March 2020, but then subsiding to 12 percent as of the first three weeks of June (the latest period covered by the survey).[6]

Figure 1
Combined Net Profit Margins During 2020
Albertsons and The Kroger Companies



While grocers continued to benefit from higher food and related sales during the second half of 2020, they also faced higher wholesale costs for food and housing supplies, as well as considerable new COVID-19 related expenses. These include expenses for paid leave and overtime needed to cover shifts of workers affected by COVID-19, both those that contracted the virus and (primarily) those that were exposed and needed to quarantine. Other COVID-19 costs include those for intense in-store cleaning, masks for employees, new plastic barriers at check-outs and service counters, and additional staffing and capital costs for scaling up of e-commerce, curbside and home delivery.

[5] In their SEC 10-Q quarterly report for the four-month period ending in June 2020, Albertsons reported that consolidated sales were up 21.4 percent from the same period of 2019 and before-tax profits were 3.5 percent of total sales. In the three-month period ending in mid-September, the company reported year-over-year sales growth of 11.2 percent and before-tax profits equal to 2.5 percent of sales. In their 10-Q report filed for the three-month period ending in early December, Albertsons showed year-over-year sales growth of 9.3 percent, and profits as a percent of sales of just 1.0 percent. Data for the Kroger Company indicates that year-over-year sales growth subsided from 11.5 percent for the three-month period ending in May 2020 to 8.2 percent for the three-month period ending in August, and further to 6.3 percent for the three-month period ending in November. Profits as a percent of sales fell from 3.8 percent to 3.5 percent, and further to 2.8 percent during the same three quarterly periods. (Source: EDGAR Company Filings, U.S. Securities and Exchange Commission. https://www.sec.gov/edgar/searchedgar/ companysearch.html.

[6] Supra 3

Many stores incur losses in normal years

The 1- to 2-percent net profit levels cited above reflect industry averages. There is considerable variation around these averages among individual stores, with some doing better and some doing worse. As one indication of this variation, the 2020 Independent Grocer Financial Survey found that, while the nationwide average profit before tax for all stores was 1.1 percent of sales in 2019, about 35 percent of the respondents reported negative net profits during the year.[7] This national result is consistent with feedback we received from California grocers, which reported that even in profitable years, anywhere from one-sixth to one-third of their stores show negative earnings. While chain operations can subsidize some store losses with earnings from other stores, a major mandated wage increase would eliminate earnings for even the most profitable stores, making cross- subsidies within supermarket chains much less feasible. As discussed below, the consequence would likely be a closure of some unprofitable stores.

Mandated wage increases would push most stores into deficits

The grocery business is very labor intensive. Labor is the industry's second largest cost, trailing only the wholesale cost of the food and other items they sell. According to a benchmark study by Baker-Tilly, labor expenses account for 13.2 percent of gross sales of grocers nationally.[8] The Independent Grocer Survey, cited above, found that labor costs account for 15 percent of sales nationally and 18.4 percent for independent grocers in the Western region of the U.S.[9]

Respondents to our survey of California grocers reported that labor costs equate to 14 percent to 18 percent of sales revenues. For purposes of this analysis, we are assuming that the wage base potentially affected by the mandated hourly pay increase is about 16 percent of annual sales.[10]

A mandatory $4-$5 per hour increase, applied to an average $18.00 per hour wage base, would increase labor costs by between 22 percent and 28 percent. This would, in turn, raise the share of sales devoted to labor costs from the current average of 16 percent up to between 19 percent and 20.5 percent of annual sales. The up-to-4.5 percent increase would be double the 2020 profit margin reported by the industry, and three times the historical margins in the grocery industry.

Potential Impacts on Consumers, Workers and Communities

In order to survive such an increase, grocers would need to raise prices to consumers and/or find substantial offsetting cuts to their operating expenses. As an illustration of the potential magnitude of each of these impacts, we considered two extremes: (1) all of the higher wage costs are passed through to consumers in the form of higher retail prices; and (2) prices are not passed forward and all the additional costs are offset through a reduction of jobs or hours worked.

[7] Supra 3

[8] White Paper, "Grocery Benchmarks Report", November 5, 2019, Baker Tilly Virchow Krause LLP.

[9] Supra 3

[10] This recognizes that not all labor costs would be affected by the hazard pay proposal. Grocers report that both in-store and warehouse staff would receive the increase, as would supervisors and managers, although some executive and administrative staff may not. In addition, costs for health coverage would probably not be affected, at least not immediately, but payroll taxes and some other benefit costs would be.

Higher costs passed along to consumers

Aggregate impacts. If a $5.00 per hour wage increase were imposed statewide and all of the increase were passed along to customers in the form of higher product prices, Californians would face a rise in food costs of $4.5 billion annually. If imposed locally, the City of Los Angeles's $5 per hour proposal would raise costs to its residents by $450 million annually, and the $4.00 per hour increase in Long Beach would raise grocery costs to its residents by about $40 million annually.[11]

Impact on household budgets. The wage increase would add about $400 to the annual cost of food and housing supplies for the typical family of four in California.[12] While such an increase may be absorbable in higher income households, it would hit low- and moderate-income households especially hard. The impact would be particularly harsh for those who have experienced losses of income and jobs due to the pandemic, or for those living on a fixed retirement income including many seniors. For these households, the additional grocery-related expenses will make it much more difficult to cover costs for other necessities such as rent, transportation, utilities, and healthcare.

According to the BLS Consumer Expenditure Survey, California households with annual incomes of up to $45,000 already spend virtually all of their income on necessities, such as food, housing, healthcare, transportation and clothing.[13] For many of these households, a $33 per month increase in food costs would push them into a deficit.

These increases would add to the severe economic losses that many Californians have experienced as a result of government-mandated shutdowns in response to COVID-19. According to a recent survey by the Public Policy Institute of California, 44 percent of households with incomes under $20,000 per year and 40 percent with incomes between $20,000 and $40,000 have reduced meals or cut back on food to save money.[14] Clearly, imposing a $4.5 billion increase in grocery prices would make matters worse, especially for these lower-income Californians.

Higher costs are offset by job and hours-worked reductions

If grocers were not able to pass along the higher costs resulting from the additional $5/hour wage requirement, they would be forced to cut other costs to avoid incurring financial losses.[15] Given

[11] Our estimates start with national U.S. Census Bureau estimates from the Annual Retail Trade Survey for 2018 (the most current data available), which indicates that nationwide sales by grocers (excluding convenience stores) was $634 billion in 2018. We then apportioned this national data to California as well as the cities of Los Angeles and Long Beach based on relative populations and per-household expenditure data from the Consumer Expenditure Survey. We then updated the 2018 estimate to 2021 based on actual increases in grocery-related spending between 2018 and 2020, as reported by the U.S. Department of Commerce, and a projection of modest growth in 2021. Our estimate is consistent with the industry estimate of $82.9 billion for 2019 that was by IBISWorld, as adjusted for industry growth in 2020 and 2021. (See IBISWORLD Industry Report, Supermarkets & Grocery Stores in California, Tanvi Kumar, February 2019.)

[12] Capitol Matrix Consulting estimate based on U.S. Bureau of Labor Statistics, Consumer Expenditure Report, 2019. https:// www.bls.gov/opub/reports/consumer-expenditures/2019/home.htm

[13] U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, State-Level Expenditure Tables by Income. https://www.bls.gov/cex/csxresearchtables.htm#stateincome.

[14] "Californians and Their Well-Being", a survey by the Public Policy Institute of California. December 2020. https://www.ppic.org/publication/ppic-statewide-survey-californians-and-their-economic-well-being-december-2020/

[15] Circumstances where stores would not be able to pass forward high costs include communities where customers are financially squeezed by pandemic-related losses in jobs or wages, or where the increased is imposed locally and customers are able to avoid higher prices by shifting purchases to cross-border stores.

that labor costs are by far the largest controllable expense for stores, it is highly likely that the wage mandates will translate into fewer store hours, fewer employee hours, and fewer jobs. For a store with 50 full-time equivalent employees, it would take a reduction of 11 employees to offset the increased wages, which is about a 22 percent decrease in staff/hours.

Aggregate impacts. As an illustration, if the full California grocery industry were to respond to a statewide $5.00 wage mandate by reducing its workforce, we estimate that up to 66,000 industry jobs would be eliminated. This is about 22 percent of the 306,000 workers in the grocery industry in the second quarter of 2020 (the most recent quarter for which we have detailed job totals).[16] If the mandate were imposed locally in the City of Los Angeles, the impact would be about 7,000 workers, and in the City of Long Beach (at $4.00 per hour), the impact would be about 775 jobs. Stores could alternatively avoid job reductions by cutting hours worked by 22 percent across-the-board.

Under these circumstances, some workers receiving the wage increases would be better off, but many others would be worse off because of reduced hours or layoffs. Customers would also be worse off because of reduced store hours, and fewer food choices and services.

Without any external constraints imposed by the local ordinances, it is likely some combination of higher prices and job and hour reductions would occur. Stores within some jurisdictions imposing the mandatory wage increase might be able to raise retail prices sufficiently to cover a significant portion of the mandated wage increase, thereby shifting the burden onto customers. However, the degree to which this would occur would vary from jurisdiction to jurisdiction, depending on the price-sensitivity of their customers and (if the mandate is imposed locally) the availability of shopping alternatives in neighboring communities that have not imposed the wage mandate.

Of course, if the local ordinances contain provisions prohibiting stores from cutting hours, then stores would be forced to pass costs on to consumers in the form of higher prices, or to close stores in those jurisdictions.

Some communities would become food deserts

Many of the up-to one third of stores already incurring losses may find it impossible to raise prices or achieve savings that are sufficient to offset the higher wage costs. For these stores, the only option would be store closure. Indeed, a consistent theme of feedback we received from California grocer representatives is that it would be extremely difficult, if not impossible, to justify continued operation of a significant portion of their stores following a government-mandated 28-percent increase in wages. This would leave some communities with fewer fresh food options.

According to the Propel LA: "The United States Department of Agriculture (USDA) defines a food desert as 'a low-income census tract where either a substantial number or share of residents has low access to a supermarket or large grocery store.' There are a large number of census tracts in Los Angeles County, including Antelope Valley and San Fernando Valley, that are considered to be food deserts. The population of food deserts is predominantly Hispanic or Latino, followed by Black and White, respectively."[17] The map also shows several food deserts in and around the City of Long Beach. The hazard pay proposal would exacerbate this problem.

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[16] Employment Development Department. Labor Market Information Division. Quarterly Census of Employment and Wages. https://www.labormarketinfo.edd.ca.gov/qcew/cew-select.asp

[17] "Food deserts in LA, an Interactive Map." Propel LA, https://www.propel.la/portfolio-item/food-deserts-in-los-angeles-county/

Closing even one supermarket in many neighborhoods would result in residents having to commute significantly farther to find fresh and healthy food at reasonable prices. Tulane University studied the impact of food deserts and concluded that while the majority of items at smaller stores are priced higher than at supermarkets, price is a consideration in deciding where to purchase staple foods, and transportation from a food desert to a supermarket ranges from $5 to $7 per trip.[18]

Thus, mandating hazard pay would likely impose significant hardships on some communities, especially in lower-income areas. The loss of a grocery store means both fewer jobs for members of the community and higher costs for all residents in the community, who must pay higher local prices or incur additional time and expense to shop.

Conclusion

Hazard pay initiatives like those passed in the City of Long Beach, and proposed in the City of Los Angeles and in other local jurisdictions, would have far-reaching and negative consequences for businesses, employees and customers of grocery stores in the jurisdictions where levied. They would impose an up-to-28 percent increase in labor costs on an industry that is labor-intensive and operates on very thin profit margins. The increases would be more than double the average profit margins for the grocery industry in 2020, and triple the margins occurring in normal years, and thus would inevitably result in either retail price increases or major employment cutbacks by grocery stores, or a combination of both. If the increased costs were passed forward to consumers, a typical family of four in California would face increased food costs of $400 per year. This would intensify financial pressures already being felt by millions of low- and moderate-income families, many of whom are already cutting back on basic necessities like food due to COVID-19-related losses in jobs and income. Establishments not able to recoup the costs by raising prices would be forced to reduce store hours and associated jobs and hours worked by employees. For a significant number of stores that are already struggling, the only option may be to shutter the store. This would be a "lose-lose" for the community. It would mean fewer jobs with benefits, less local access to reasonably-priced food, and more time and expense spent by customers that would have to travel greater distance to find grocery shopping alternatives.

[18] "Food Deserts in America (Infographic)," Tulane University, School of Social Work, May 10, 2018. https://socialwork.tulane.edu/blog/food-deserts-in-america