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How Government Reduces Employment

Murray Weidenbaum

At a time of widespread concern that government is not doing enough to promote employment, we can no longer overlook the other side of the coin — the many ways in which government is doing too much, by reducing the ability of the private sector to create jobs. Through a variety of legislative mandates on and regulation of employers, government laws and rules weaken the demand for labor and, often, the supply of labor as well. Although that is not the intent of such legislation, the rising presence of government in the employment process slows down the growth of employment in the United States. The sad, hard fact is that more people would be at work if government were a less conspicuous force in the American economy.

As will be shown in detail, government, especially the federal government, conducts many activities which greatly influence the ability of the private sector to create jobs. The term private sector is not a misnomer because it covers non-profit as well as business enterprises. Colleges, hospitals, and museums are affected as much as business firms. And the direction of impact is the same and thus cumu-

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lative — each of the government programs discussed below raises the cost of hiring people and thus discourages the creation of new jobs.

The central point of this study should not be misinterpreted. The aim is not to oppose efforts to eliminate discrimination, protect unskilled workers, or help the disabled. Rather, this report is designed to show that, quite unwittingly, much of the government's social legislation has been written in a way that is oblivious to its negative impact on employment. If that undesirable side-effect accompanied only one or two of these programs, perhaps it could be soft-pedaled. However, because the harm to employment is so pervasive and cumulative, it cannot be ignored. Surely, ways can be developed of meeting these important social objectives with less economic damage to the intended beneficiaries. However, the design of specific reforms is beyond the scope of this study.

Civil Rights Act

Of the numerous laws and regulations that discourage or slow down job creation, the most conspicuous example is the Civil Rights Act, including the affirmative action program. Although most of us do not like to think about it, this popular law does have some negatives. For example, it lengthens the amount of time that many jobs stay vacant. Any employer subject to affirmative action requirements who simply goes out and hires people does so at his or her peril. In order to reduce — but not eliminate — the likelihood of being sued, prospective employers must go through a lengthy and expensive process that includes advertising in specified types of media. The advertised position must stay open long enough to provide those interested with an adequate opportunity to respond.

I once had the occasion to study a fascinating, unintended phenomenon caused by this legislation. It turns out that an admonition in the affirmative action guidebook issued by the U.S. Equal Employment Opportunity Commission — namely, that covered employers should advertise in media specifically directed toward minorities — has helped to generate a new market. An example was the *National Black Register*, which charged $85 per column inch at a time that the Sunday edition of the *New York Times* charged $64 an inch to reach its circulation of 1.4 million. The *Register* was distributed to 42,500 organizations and individuals, a circulation equal to 3 percent of the *Times*.[1]

A study of affirmative action induced advertising by colleges and universities in the mid-1970s concluded that the cost was "at least $6 million a year, though few professional placements ever result from such national advertisements."[2] Even though the outlay is likely much larger now, this advertising expense seems relatively insignificant when compared with the total cost imposed by the civil rights laws, including law enforcement, compliance, and resources directed from other activities. However, to most citizens, $6 million still is a great fortune.

Precise measures of the total costs imposed by civil rights laws and regulations are illusive. Nevertheless, *Forbes* earlier this year came up with an aggregate estimate of $236 billion a year or approximately 4 percent of the gross domestic product.[3] Because the *Forbes* estimate is so dramatically large, it is useful to examine its individual elements. For example, the direct compliance expenses of private business necessary to respond to civil rights rules are estimated at a smaller but still substantial amount — $5-8 billion a year. Educational institutions spend $11 billion annually for the purpose. These direct costs are clearly very substantial. However, the truly huge costs imposed by these regulations — the remaining $220 billion plus — are indirect, such as the opportunities foregone because of the diversion of management time, energy, and resources.

Wrongful Termination Liability

If civil rights laws are an extremely conspicuous aspect of government's impact on the employment process, judicial narrowing of employers' right to fire is among the least publicized. Yet the repercussion of the resultant rise in wrongful-termination liability is very substantial. The Rand Institute for Civil Justice has revealed the high costs that have resulted from the tendency of state courts around the country to change traditional employment law.

As recently as a decade ago, courts in all but 13 states continued to recognize the longstanding common-law doctrine that allowed private employers to fire "at will" workers not protected by collective bargaining agreements or specific statutes. In recent years, a virtual landslide of cases has brought the law closer to the requirement that an employee can be fired only for cause. Courts have also been allowing plaintiffs to collect punitive damages as well as lost wages when they can prove wrongful conduct on the part of the employer. Rand researcher James N. Dertouzos sums up the findings, "In a nutshell, the efforts of the state judiciaries to protect workers' job security are altering employers' hiring and firing practices. And one of the results is less hiring."[4]

A Rand study notes that, due to the substantial costs associated with wrongful termination lawsuits, firms have responded by treating labor as a more expensive input to production. They estimate that, in the adjustment process, aggregate employment drops by 2-5 percent.[5]

Family Leave Act

The Family and Medical Leave Act of 1993 is the most recent example of government-imposed costs on the employment process. It is fascinating to recall the debates on the bill as it wended its way through the Congress. Proponents kept asking, "How could anyone object to this obviously desirable measure which doesn't cost anything?" Just as soon as the bill became law, we were "reminded" that employers are required to maintain health insurance coverage for employees on leave.

The costs of mandated benefits are ultimately borne by employees themselves.

The General Accounting Office (GAO) estimates this cost alone at $674 million a year.[6] One area of uncertainty is the ability of employers to recover the cost of the premiums they pay to employees who do not return from the leaves of absence mandated by the new law. Nor does this estimate cover the money involved in hiring and training temporary workers, who may be both more expensive and less productive than the employees on leave.

Research supports the thesis that the costs of mandated benefits such as employee leave are ultimately borne by the employees themselves. MIT economist Jonathan Gruber studied three states that passed laws, effective in

1976, requiring basic health insurance to include comprehensive coverage for maternity expenses.

Gruber estimates that the mandate increased the cost of insuring women of child-bearing age by 1 to 5 percent of their wages. He arrived at this conclusion by analyzing data from the Census Bureau. Gruber found that real wages of married women of child-bearing age fell by 3.4 percent between 1974-75 and 1977-78 in the three states that required maternity coverage. In striking contrast, real wages for the same segment of the population rose 2.8 percent in five control states that did not require such coverage. At the same time that the "benefited" group of employees suffered a loss of real wages, employment among married women of child-bearing age declined. Not surprisingly, hours per worker in that population category rose. That is a logical response by employers since the fixed costs of employing these women had risen, regardless of the length of the work week.[7]

Gruber concluded that the increased cost of this employee-leave mandate was shifted to the women's wages, or to their husbands' wages if they had insurance. He found similar effects from the passage of the 1978 Federal Pregnancy Discrimination Act, which extended comprehensive maternity coverage to insured women throughout the United States.[8] In sum, the enactment of this government mandate seems to result in lower employment, lower wages, and higher hours worked.

Mandated Health Care

The largest prospective government mandate on employment is health care. At this point, nobody knows what specific type of health "reform" will be enacted by the Congress, or even if such a bill will become

law in the near future. A recent roundup of views of various labor economists is not comforting:[9]

> Barbara Wolf of the University of Wisconsin: "You'd expect to see fewer low-wage jobs because it would be more expensive to hire less-skilled workers. There's reason to be very concerned and very cautious."
>
> Daniel Hamermesh of the University of Texas at Austin: "Either there are going to be job cuts or wage cuts or, more likely, a combination of both."
>
> June O'Neill at Baruch College: "Many workers will be totally unaffected, but it will have a serious effect on low-wage workers."
>
> Robert Topel of the University of Chicago: "Somebody who keeps their job and has health insurance may be better off. But you have to think about the millions who no longer have jobs."

This near unanimity on the part of labor economists concerning the negative effects of employment mandates contrasts sharply with the view of former consultant Ira Magaziner, the top Clinton health-care adviser, who was recently quoted as calling worries about job losses "crazy."[10] Perhaps the Clinton Administration should reexamine its position on limiting the portion of mental health care to be covered by its health plan. After all, should it be enacted, the number of people meeting Magaziner's definition of crazy is likely to skyrocket.

Some analysts have tried to estimate the employment effects of imposing a health-care mandate on American business. Professors June O'Neill and David O'Neill of Baruch College estimate that the increased cost of providing workers with health insurance will lead to the loss of 3.1 million jobs. Not surprisingly, the O'Neills show that low-wage industries (such as restaurants) would be hit very hard. The cost of the Administration's health-insurance package is likely to be the same for a highly paid worker as for an employee with a more modest wage scale. Thus, the researchers estimate that a health-care mandate will result in an increase of 5 percent in labor costs in construction and a 19 percent rise in eating and drinking establishments (see Table 1).[11]

The increased cost of providing workers with health insurance will lead to the loss of 3.1 million jobs.

As would be expected, other analysts have come up with different figures on the employment impact of the Clinton health program. Economist Alan Krueger estimates that the plan would mean 200,000-500,000 fewer jobs in 10 years than would otherwise be the case; depending on the elasticity of labor demand and supply; his preference is toward the lower end of the range.[12] In contrast, presidential adviser Magaziner believes that "some gain" in employment is likely in the short run as well as the long run.[13]

The short-term effects of imposing a health-care mandate on employers differ from the long-run effects in important respects. In the short-run, the great bulk of the costs (80 percent in the basic Clinton plan) is paid by employers, which should reduce their demand for labor. In the longer-run, those costs are largely shifted back to workers in the form of lower real wages and reduced nonmedical benefits.[14] As a result, the effect on the supply of labor is likely also to be negative. In any event, the *New York Times* may have identified most succinctly a fundamental shortcoming of mandating health-care benefits — the lack of adequate financing: "The tooth fairy, who has emerged as a major policy player, doesn't pay for health care."[15]

Table 1

Impacts of Clinton Health Care Mandate

	Increase In Labor Costs (Percent)	Job Loss
Eating and drinking establishments	19.1	828,000
Other retailing	7.9	726,000
Construction	5.1	241,000
Personal services	11.3	217,000
Agriculture	15.6	194,000
Private household services	32.9	190,000
Repair services	8.2	77,000
All other	2.8	627,000
Total Economy	3.8	3,100,000

Source: Employment Policies Institute.

Minimum Wage Legislation

Without doubt, of all the governmental regulations affecting employment, the statutory minimum wage has been the focus of the greatest amount of professional attention. With a few, albeit conspicuous, exceptions, the great mass of the research has concluded that increases in the compulsory minimum wage cause a rise in unemployment. The segment of the workforce most affected is those at or near the minimum wage. This is a group consisting primarily of teenagers and others with low skills who thereby lose the opportunity to gain their initial work experience.[16]

A 10 percent increase in the minimum wage generates a 1-3 percent increase in unemployment.

On the basis of analyzing a great number of studies, the Minimum Wage Study Commission concluded in 1981 that a 10 percent increase in the minimum wage generates a 1-3 percent increase in the unemployment among those holding minimum wage jobs, mainly teenagers. A smaller adverse effect was noted for 20-24 year olds, mostly because a smaller percentage of that age group earns the minimum wage. Confidence in the commission's estimates is enhanced by the fact that the 1981 findings were recently replicated using panel data from all 50 states over a period of 15 years.[17]

What about the workers who manage to retain jobs at the new minimum wage? Here, the data provide an interesting twist. Many minimum-wage workers are the dependent children of the middle class. Much of the gain from a higher minimum would go into surfboards and stereos, not into rent and baby formula.[18]

More seriously, several economists have demonstrated that the benefits of the minimum wage — to those receiving it — are offset by reductions in other benefits. For example, a study of the 1967 rise in the statutory minimum wage showed that workers gained 32 cents an hour in money income, but lost 41 cents an hour in training benefits, for a net loss of 9 cents an hour in total compensation.[19]

It is instructive to estimate the effects of the recent proposal by Secretary of Labor Robert Reich to raise the compulsory minimum wage from $4.25 an hour to $4.50. We can obtain a rough idea of the disemployment effect by assuming that the past relationship continues to hold — a 1-3 percent increase in the unemployment of the affected portion of the labor force for each 10 percent rise in the wage. Let us apply that ratio to the approximately 5 million affected employees, those now earning between $4.25 and $4.50 an hour. This procedure yields an increase in unemployment in the range of 29,500 to 88,500 workers. To those who dismiss the importance of such "small" numbers, it is pertinent to ask when was the last time they generated 80,000 new jobs — or 20,000 — or even 20?

Studies of retail establishments in New York found that many stores responded to increases in the minimum wage by reducing commission payments, eliminating bonuses, and cutting paid vacations and sick leave. For every 1 percent increase in the minimum wage, restaurants reduced shift premiums by 3.6 percent, severance pay by 6.9 percent, and sick pay by 3.4 percent.[20]

It must be noted, however, that a distinguished trio of economists has recently come up with a contrary conclusion. David Card and Alan B. Krueger of Princeton and Lawrence Katz of Harvard (currently at the U.S. Department of Labor) estimate that the 27 percent rise in the statutory minimum wage in April 1990 had virtually no negative effect on employment. The three researchers reached this conclusion after studying the question from several viewpoints — using data on individual states and on fast-food restaurants in Texas, as well as examining the impact of the 1988 rise in the California minimum wage.[21]

The disability insurance program resembles an early retirement system.

As would be expected in the case of research that departs from the conventional wisdom, many criticisms have been leveled at these contrary studies. The studies do not take into account the possibility that some firms may go out of business because of the cost increase to them from raising the compulsory minimum wage.[22] Also, the three researchers ignore changes in product demand among the establishments analyzed. Perhaps employment would have increased had the minimum wage not been raised.[23] Moreover, the effects of a rise in the minimum wage may not show up quickly. Employers need time to make personnel decisions and to substitute machinery for workers; the studies cover only a year or two.[24]

The bulk of the evidence continues to support the traditionally negative view of minimum-wage laws. Interestingly, a recent study has also examined the effects of minimum-wage increases on the American restaurant industry. Using Bureau of Labor Statistics data from 1980 through mid-1991, they estimate the effects of two minimum-wage hikes which occurred in 1990 and 1991 (bringing the minimum wage to $4.25 an hour). They conclude that a 1 percent increase in money-wage rates reduced employment in eating and drinking places by 0.83 percent.

The first of these two minimum-wage hikes was less significant. At that time, the minimum wage had not been increased in almost a decade, and most establishments were already paying in excess of the federal minimum. Nevertheless, allowing for this as well as the fact that some portion of wage increases is passed on to consumers in the form of higher prices, their estimated range of possible job losses associated with the rise to a $4.25 minimum wage is 111,000 to 130,000 jobs.[25] A study of the federal minimum-wage increases in an earlier period (1979 and 1980) also found negative effects on employment. The employed individuals who were affected by the increases in the minimum wage were 3 to 4 percent less likely to be employed a year later.[26]

Other Regulation of Employment

By no means have we exhausted the list of costs that government imposes on the job creation process in the United States.

Disability Insurance

Some public-sector actions operate to reduce the demand for labor, while others decrease the supply of labor. Let us examine the disability portion of the social security program (technically, this is the "D" of OASDI, or old-age, survivors, and disability insurance — the formal way of describing social security). The disability program is a cogent example of a government mandate reducing the labor supply.

Social security disability insurance beneficiaries rarely return to work. Once initial eligibility is established, the program resembles an early retirement system. In 1987, fewer than 8,000 disabled beneficiaries — less than one-half of one percent of the total — successfully completed a trial work period and thus stopped receiving their monthly social security check.[27] In plain English, the more generous the benefits, the less willing are the recipients to return to work.

The disability program creates an employment disincentive, encouraging working people with disabilities to drop out of the labor force and nonworking beneficiaries to remain out of the work force. As benefit levels rise, the number of disabled beneficiaries expands and the male labor force participation rate declines. Between 1955 and 1985, for example, the portion of 45 to 55 year old men not in the labor force rose from 2.5 percent to 8.2 percent; among 55 to 65 year old males, the ratio climbed from 12.1 percent to 32.1 percent.[28]

OSHA

While the disability benefits reduce the supply of labor, the rules and activities of the Occupational Safety and Health Administration (or OSHA, the small business executive's favorite four-letter word) operate to reduce the demand for labor. That feat is accomplished by increasing the indirect costs of maintaining a company work force. Virtually every serious study of OSHA concludes that, although the costs are substantial, the benefits, if any, are modest. Most available studies fail to show examples where the benefits of OSHA standards exceed the costs, although the recent OSHA hazard communication standard is a prominent exception.[29]

Studies of OSHA performance in the 1970s concluded that the agency had no statistically significant impact on worker safety.[30] However, some modest improvement may have occurred in the 1980s. OSHA now prevents from 1 to 2 injuries involving at least one lost day of work per 1,000 workers annually.[31]

At the present time, Congress is considering an ambitious extension of OSHA. In July 1993, the Senate and House Committees on Education and Labor each held hearings on the proposed Comprehensive Occupational Safety and Health Reform Act. This bill would amend the existing OSHA statute to require each employer of 11 or more (an estimated 1.6 million firms) to undertake two new initiatives. The first is to create a joint labor-management safety and health committee which is granted broad authority to influence workplace safety and health programs. The second is to establish and implement a detailed written safety and health program.

The pending OSHA bill would preclude any consideration of economic impact in setting job safety or health standards.

In addition, OSHA inspectors would no longer have to go to court in order to get the authority to order an immediate shut-down if they considered a business operation unsafe. Each inspector would have discretion to do so. Also, the pending bill would preclude any consideration of economic impact in setting job safety or health standards.[32]

The Employment Policy Foundation has estimated that this package of changes in employment regulation would cost the American economy nearly $62 billion a year, a figure representing 11.8 percent of 1990 net business income. The major components of this very large cost estimate are the required new safety and health programs, training, and committees (for a total of $38.7 billion). Also significant are the costs of recordkeeping and reporting ($3.6 billion) and litigation ($8.6 billion). The cost of monetary penalties is estimated at "only" $90 million annually.[33]

Workers' Compensation

Another expensive burden on the employment process, and one whose cost is rising very rapidly, is workers' compensation. The cost of this mandate to U.S. companies is escalating. In real terms, the cost of workers' compensation more than doubled from 1977 to 1991. In nominal terms, this required outlay rose from $14 billion in 1977 to $55 billion in 1991. During the same period, lost work time due to injuries and illnesses rose far more modestly, from about 60 days per 100 workers per year to approximately 70 days per 100 workers. Even taking into account the rise in unit medical costs, the workers' compensation program is an increasingly generous one — and extremely costly to employers.[34]

The cost of workers' compensation rose to $55 billion in 1991.

Some legislation affecting jobs is so recent that it is premature to attempt to estimate the specific impacts on labor costs and on labor supply or demand. An example is the Americans With Disabilities Act (ADA), which took effect on July 26, 1992 in the case of employers with 25 or more workers (effective July 26, 1994 in the case of employers with 15 or more employees). The officials charged with carrying out the statute explain that it will take extended litigation to determine the full scope of the vague and often sweeping provisions of the law, which covers an estimated 43 million Americans. However, early experience indicates that the costs will be substantial. The Equal Employment Opportunity Commission is

now receiving about 1,000 ADA claims each month — on top of its already heavy caseload dealing with other discrimination claims.[35]

Conclusion

Amidst all the scary headlines about massive layoffs, some important but undramatic perspective is necessary. It is true that, in recent months, IBM, P&G, et al. have announced unprecedented large reductions in their work forces. But one of the best kept secrets in the U.S. economy continues to be that the total number of jobs is growing. Net job expansion from late 1991 to late 1993 has averaged a little over 1 percent a year. However, that is far below the rate of employment growth during typical recoveries. We should be able to improve on that record.

The upbeat point that needs to be made is that the concern with removing governmental obstacles to job creation is reasonable and manageable. There is no need to throw up our hands in despair. There are many reasons for the slowdown in job formation in the American economy and some of them are amenable to sensible policy changes.

Surely, an important and often overlooked factor is the rising load of regulation and mandates that government is imposing on business and other employers. The direct cost of meeting employment mandates imposed by the federal government has risen far faster than wages and salaries. Federal mandates were equal to almost 3 percent of total wages and salaries in 1960. By 1990, the ratio of mandated benefits to wages and salaries had more than doubled, to over 7 percent. It is one thing for the proponents of these mandates and regulations to justify them on social grounds. Many, if not most of them, would flunk the benefit-cost test. If that was not the case, why do the proponents of more employment regulations — such as the Comprehensive OSHA Reform Act — urge Congress to keep economic analysis out of the regulation-writing process?

The indirect costs of employment regulations — many of which are both substantial and hidden — all share a common characteristic: they make adding workers to the payroll more expensive. At least initially, they also create a substantial gap between the cost to the employer and the benefit to the employee. These facts are often lost amidst political debates on these issues. Many times, more regulation seems a costless way to achieve policy goals.

The costs of employment regulations share a common characteristic: they make adding workers to the payroll more expensive.

Merely reviewing the estimates presented in this paper is staggering (see Table 2). Compliance with the civil rights laws may cost the American economy as much as $236 billion a year or 4 percent of the gross domestic product. Wrongful termination lawsuits may result in lowering employment by 2 to 5 percent. Mandating health care may involve the loss of 3.1 million jobs. In addition, employer costs are rising rapidly for workers' compensation. Moreover, the Clinton Administration appears to be developing further impositions on the job creation process, such as another increase in the statutory minimum wage.

In the words of University of Chicago law professor Richard A. Epstein, "Public discourse proceeds as if employment laws are un-

Table 2

Estimates of Economic Cost for Major Employment Regulations and Mandates

	Program	Estimated Cost
1.	Civil rights programs	$236 billion a year (or 4% of GDP)
2.	Wrongful termination lawsuits	2-5% lower employment
3.	Parental leave insurance costs	$674 million a year
4.	Mandated health care	3.1 million fewer jobs
5.	Compulsory minimum wage	1-3% increase in unemployment for each 10% increase in minimum wage
6.	Comprehensive OSHA Reform	$62 billion a year
7.	Workers' compensation	$55 billion a year

Sources: As cited in text: (1) see endnote no. 3; (2) see endnote no. 5; (3) see endnote no. 6; (4) see endnote no. 11; (5) see endnote no. 17; (6) see endnote no. 33; (7) see endnote no. 34.

related to wage levels, job creation, or labor output . . . ."[36] His colleague, economist Sam Peltzman, states the matter more pungently: "People who say there is no trade-off between regulation and employment are smoking something."[37]

On occasion, we can find specific evidence to support the close — and inverse — relationship between onerous government regulation and the willingness to hire. Here are two recent examples:

WorldClass Process Inc., a new and growing Pittsburgh processor of flat-rolled steel coils, has increased its work force to 49. According to the company's chief financial officer, "We're going to keep at 49 as long as we can," in order to avoid being subject to the 50 or more employees threshold for coverage under the Family Leave Act.[38]

Similarly, the Schonstedt Instrument Company of Reston, Virginia, a profitable, high-tech firm, deliberately keeps its work force below 50 employees. It does so in order to avoid having to file Form EEO-1 every year. The company's president makes the point effectively, although not in scholarly fashion:

> . . . a friend went over 50 employees on a government contract. He gave me his EEO file . . . it weighs more than 8 pounds . . . I have kept my employment under 50.[39]

Perhaps fate will arrange a meeting between Mr. Schonstedt and Ira Magaziner. The tooth fairy could serve as the referee.

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