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ABSTRACT

Differences in the level of total compensation paid to individuals--known as "compensating differences"--reflect the market valuation of services offered, skills involved in delivery of services, and difficulty in acquiring those skills. Differences in the composition of the compensation package reflect the needs and circumstances of the individuals offering labor services. A mandate--such as the proposed employer mandate in health reform--is imposed to alter either the level or composition of total earnings. In its most benign form, the mandate reallocates the form of compensation. In most cases, a mandate raises employer costs and reduces wages, resulting in a decline in employment. If employers are required by law to pay for health insurance benefits, they will attempt to shrink cash wages by the full cost of the mandate. As cash wages are reduced, an increasing number of employees will find alternatives outside the labor market. Employers will be forced to absorb some of the mandated cost, operate with higher total labor costs, and adjust employment levels downward. Workers are uninsured today because they perceive the value of cash to be greater than the insurance they could buy. Policy makers' current fascination with studies finding no employment effects from an existing mandate--the minimum wage--is misplaced. With existing examples of misguided employer mandates, a strong case can be made against the imposition of further federal mandates and for market-driven responses to employer and employee needs. (YLB)

EMPLOYMENT
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Mandates in Employment

A History of Added Burdens On The Unskilled

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Executive Summary

University of Massachusetts, Amherst economist Simon Rottenberg's examination of mandates in employment is a stark reminder of the potentially devastating effects of mandated employer-provided health insurance. Commissioned by the Employment Policies Institute, the study not only points out the differences among various occupational categories but explains how these factors determine differences in the size and composition of compensation packages. In the context of today's debate, it asks, and answers, why many working people remain uninsured. Additionally, it dramatically demonstrates the unequal—and particularly harsh—effects of employer mandates on the group most in need of insurance benefits: the unskilled workers.

Taken as a whole, the author suggests that mandates must not be considered in their individual context, but in the context of all mandates. He adds that policy makers' current fascination with studies finding no employment effects from an existing mandate—the minimum wage—is misplaced. With history replete with examples of misguided employer mandates, the study makes a strong case against the imposition of further federal mandates, arguing instead for market-driven responses to employer and employee needs.

Differences in the *level* of total compensation paid to individuals are known as "compensating differences" and reflect the market valuation of the services offered, the skills involved in the delivery of those services, the difficulty in acquiring those skills, as well as other factors. Differences in the *composition* of that compensation package reflect the needs and circumstances of the individuals offering labor services.

A mandate—such as the proposed employer mandate in health reform—is imposed to alter either the level or composition of total earnings. In its most benign form the mandate merely reallocates the form of compensation. For example, attempts to artificially raise the wages paid to labor in order to increase total compensation can be expected to result in offsetting reductions in other parts of the pay package, leaving total compensation—and therefore employment—unchanged.

Yet this benign, "harmless" mandate is rarely, if ever, witnessed in practice. While many have argued publicly that the costs of a mandate can be shifted back onto wages or other benefits, this view is not entirely accurate. In most cases, the effect of a mandate will be to both raise employer costs *and* simultaneously reduce wages, resulting ultimately in a decline in employment.

If employers are required by law to pay for health insurance benefits, they will of course attempt to shrink cash wages (or some other component of the compensation package) by the full cost of the mandate. But employers only will be successful in fully shifting this mandated cost if their workers are indifferent to the level of their cash wages. However, workers do care about the cash wages they receive, and as those cash wages are reduced an increasing number of them will find alternatives outside the labor market. To retain the needed number of workers employers will be forced to absorb some of the mandated cost and therefore operate with higher total labor costs. Costs which have not been shifted will be regained by downward adjustments in employment levels.

Why are some workers uninsured today? In harsh economic terms it is because they perceive less value in paying to acquire the benefit of insurance than in keeping the money in their pockets—using it to put food on their dinner table for example. Effectively they perceive the value of cash to be greater than the insurance they could buy. It is these discrepancies in perceived values which most often lead low skilled and low paid workers to opt out of the employer-sponsored benefit. This is a perception that will remain unchanged unless their income rises. If an increase in their income is the ultimate goal of health reform, we must re-evaluate our assumptions about mandates. We must be ready to accept the more limited employment opportunities that inevitably accompany higher compensation costs.

This will have dire consequences for unskilled workers. Under a mandate they will be forced to produce more in order to afford the benefits we want them to have, since the mandate effectively increases the minimum level of skills one is allowed to offer in the labor market. At the same time, the number of jobs for which they are qualified is greatly diminished. In the end, the "free" insurance they are supposed to receive from their employers comes at a very high price.

Overall, Dr. Rottenberg's assessment of mandates clearly indicates the need for an honest appraisal of our actions in mandating health insurance. A mandate is an effective hike in total compensation, and we must address the employment consequences of that policy.

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Introduction

Diverse influences affect the behavior of those who sell and those who buy labor services. These influences vary for different occupational categories, reflecting the differences in size and composition of compensation packages as well as the characteristics of the work forces. For example, older workers are likely to be more concerned with retirement income issues than are younger workers; married workers show a greater preference for participating in employment-based health insurance than do single workers; and, higher income workers are more concerned with the tax consequences of compensation arrangements than are lower income workers. The compensation packages offered by employers reflect both the preferences of their workforce as well as the constraints imposed by financial, legal and market forces.

...mandates have in fact long been a part of intervention in the marketplace. Indeed, the most persistent problem with a discussion of health care mandates is that it takes place in a vacuum, as if no other mandates existed in the federal code.

The compensation packages that result from the operation of the labor market are altered whenever legislative or judicial actions require a different set of outcomes. Sometimes these actions affect the labor market indirectly, as when they impose added costs—taxes, fines, and other penalties—on the buyers of labor services in order to alter the prevailing patterns of behavior. At other times these actions are directly prescriptive (commonly referred to as mandates) such as the proposed requirement that employers pay for workers' health insurance.

Although to many people the issue of federal mandates arose in the context of the debate over health care reform, mandates have in fact long been a part of intervention in the marketplace. Indeed, the most persistent problem with a discussion of health care mandates is that it takes place in a vacuum, as if no other mandates existed in the federal code. In fact, the assessment of the desirability of any proposed mandate must be made in the context of already existing mandates. It is not just the cost of a given mandate that must be evaluated, but the sum of those costs across all mandates. Some of the major mandates already in place, along with proposals to revise them, are discussed in the appendix to this paper.

The Effects of Mandates on Employment

Terms of employment that are mandated by law can, in principle, be superfluous, if they are set at levels lower than those that would occur in unconstrained labor markets. If, on the other hand, they are set at higher levels than those which prevail in the marketplace, they generate behavioral adjustments in labor markets. The ultimate effect of these adjustments need not be in the best interests of the intended beneficiaries and can, in fact, have an adverse effect on those whom the law had sought to assist.

Labor markets are sets of institutional arrangements for the exchange of labor services. Firms buy labor services; individuals sell them. Labor markets are differentiated, one from another, by the qualities of the services that are bought and sold—levels of skill, degrees of responsibility, and other such characteristics that are required for the work that is to be done.

If an outside constraint is imposed which artificially raises the compensation paid to low-wage labor, then the number of individuals employed to deliver those labor services will be diminished.

The terms and conditions of employment are the prices paid for those services. The price paid for labor services is typically a package whose components may include cash wages paid currently, deferred payments that are made at some point in the future (typically after retirement), payments in-kind such as housing, meals, day-care for employees' children, transportation and parking, as well as health and life insurance. In addition to the already enumerated items (commonly referred to as fringe benefits), the compensation package also includes other components that require expenditures by the employer—training as well as protection against adverse experiences while at work, for example. That is to say, the purchase price of labor services includes everything that imposes costs upon the buyer as a consequence of the purchase of labor services, whether received by workers directly or indirectly.

In competitive labor markets in which constraints are not imposed on the terms for the exchange of labor services, the size of the total compensation package will be determined by the scarcity of the supply of labor services relative to the demand for those services. If a class of labor is used in the production of a much-desired commodity or service, if there are no good substitutes for that class of labor, and if satisfactory performance in that class requires skills that are learned arduously and only after a long period of training, the price of that labor will be high. Conversely, if the commodity or service being produced is wanted only weakly, if there exist good substitutes for the relevant class of labor, and if performance requires only light physical exertion and a low level of skill and literacy, then the price for that labor will be low, with many individuals meeting the requirements for the position.

The differences between the payments for the services of workers with high earnings and those with low earnings are known as "compensating differences." These differences reflect the time and effort spent in the acquisition of skills, the risks taken in confronting hazards at work, and other such differences in the requirements for successful performance.

If, however, differences in earnings in different occupations are compressed by legal mandates, the skills embodied in the working population will be distorted. As a consequence, the wrong set of commodities and services will be produced and the community's overall welfare will be diminished. If an outside constraint is imposed which artificially raises the compensation paid to low-wage labor, then the number of individuals employed to deliver those labor services will be diminished.

This is true for two reasons. First, the higher price of labor will be reflected in a higher price for the goods and services produced by that labor; the desired quantity of that commodity or service by buyers will, therefore, be smaller, as will be the quantity of resources (including labor) used in its production. Secondly, the higher price of labor, relative to the prices of other resources, will cause producers of that commodity or service to search out alternative methods of production that employ less labor and more of other resources that can be substituted for labor. This can lead to substitution of different classes of labor—high skill labor for low-skill labor, or replacement of the affected class of labor with additional machinery and equipment.

In all cases, the determinant of the quantity of labor that is purchased is the total cost of the compensation package; it is not affected by the relative magnitudes of the components that make up the bundle. If outside influences, such as a legally imposed mandate, cause one of the components to be enlarged, other components will shrink.

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Shifting the Costs of a Mandate

It is sometimes said that after a mandate is imposed, the cost of the total compensation package will remain unchanged as a result of the readjustment of the components of the compensation package. Under this view of the world, employers simply shift the cost of a mandate back onto wages or other benefits, leaving the cost of labor unchanged. This is not correct. In most cases, the effect of a mandate will be to *both* raise employer costs and reduce wages.

If, for example, health care insurance benefits are enlarged by law, employers will attempt to shrink cash wages (or some other component of the compensation package) by the full cost of the mandate. But employers only will be successful in fully shifting this mandated cost if, and only if, their supply of labor services is both fixed and indifferent to the level of cash wages. In this limited case, the whole cost of the expanded health care benefits indeed falls upon workers in the form of reduced wages. But occupations and industries where the supply of labor is indifferent to the amount of cash wages in the total compensation package, rarely—if ever—exist in the economy. Overwhelmingly, workers care about the amount of cash they receive as part of compensation.

As was said at the outset of this paper, the composition of compensation packages is determined by a variety of forces, not the least of which are the preferences of the workers in those markets. Employers will find it impossible to respond to a mandated cost by reducing cash wages dollar-for-dollar whenever the workers prefer cash wages to benefits. Even though the employer costs of a compensation package remain the same, its value is assessed at a lower level by workers. Consequently, employers will find it necessary reduce cash wages by less than the cost of the mandate, effectively increasing total compensation costs. Employment costs which have not been shifted will be made up for by adjustments in employment *levels*.

It may seem strange in the middle of a health care debate focusing on increasing insurance coverage to talk about workers not valuing health insurance; but in fact, this is precisely what takes place on a regular basis. Many workers decline to participate in employer-sponsored health insurance because the direct costs they must pay exceed the value of the benefit. Clearly, these are often low-income individuals for whom forgoing wages is impossible; but, that is merely another way of stating that they prefer cash wages to benefits unless the cost of those benefits is offset to some degree with higher wages. Rightly or wrongly, workers perceive themselves to be better off having cash in lieu of coverage.

Occupations and industries where the supply of labor is indifferent to the amount of cash wages in the total compensation package, rarely—if ever—exist in the economy. Overwhelmingly, workers care about the amount of cash they receive as part of compensation.

A health care mandate forces a reallocation of compensation away from this preferred standard by requiring lower cash wages and higher benefits. When workers value benefits at less than their cash equivalent, it is impossible to fully shift the cost back onto wages. Attempts to shift the cost fully will result in a compensation package less attractive to workers than before, resulting in a lower supply of workers. As a consequence, wages must rise somewhat to reflect the differing value placed by these workers on cash vs. benefits. A benefit mandated by law will enlarge the total compensation package paid by the employer ***and*** will simultaneously reduce the cash wage or the size of other benefits received by the employee.

Note carefully that this statement should not be misconstrued to say that workers at any pay scale do not value the provision of health care benefits. It merely states that in order to offer compensation packages that are as attractive to workers after a mandate as before a mandate, the value of the total compensation must be increased. No better evidence of this exists than the number of individuals who elect not to participate in employment-based insurance programs when offered the chance to reduce their wages and acquire coverage.

Unless workers are indifferent between cash wage and benefits, a benefit that is required by law to be included in the compensation package received by workers is effectively an excise tax on the exchange of labor services. Like other taxes, it will generate quantity effects and will reduce the quantity of labor services exchanged in each time period. The tax—that is to say, the cost of the benefit—will fall upon both buyers and sellers; the compensation packages paid by employers will rise and the cash wage component of those packages will fall. The fact that the whole cost of the benefit is *nominally* borne by the employer, does not affect the fact that the cost of the benefit really falls on both employers and workers.

Note that the same result would apply if the health care mandate were imposed upon workers rather than employers; that is to say, if workers were required to purchase insurance rather than requiring employers to provide insurance. In this case, workers would find their disposable incomes directly reduced and, as a consequence, would offer less labor services to the market unless wages were raised.

Mandates and Low Wage Workers

The proportions of the benefit's cost borne by employer and employee depend on whether the quantities demanded and supplied of labor are strongly or weakly responsive to changes in its price. If, as in the case of low-wage employment, a market-adjusted decline in cash wages in response to a mandate is frustrated by minimum wage laws, the cost of a mandated benefit falls wholly upon employers. Employers can be expected to seek out strategies of avoidance by arranging to purchase labor services exempt from the mandate, or they will resort to avoiding the cost by reducing the quantity of labor they employ. They can do this by closing shop completely or by dismissing some employees and re-engineering the way in which they carry out their business.

Employees who are dismissed by these processes either withdraw from the labor force (their valuation of the compensation package they are allowed to accept falls below their reservation wage, or the wage at which they no longer find work sufficiently rewarding in which to engage) so that their productive inputs are totally lost to the economy; become self employed; or, find other wage employment. Because they will then be resorting to "second best," those who find other wage employment will add less to the economy's output than if they had remained in the employment from which they were dismissed.

The fact that the whole cost of the benefit is <u>nominally</u> borne by the employer, does not affect the fact that the cost of the benefit really falls on both employers and workers.

Those who sell labor services are diverse in their interests and preferences. Young, unmarried workers may prefer to have a very large portion of their compensation in cash paid currently; somewhat older workers may prefer a smaller portion in cash and an additional portion that will provide them with income after retirement; still older workers may prefer a larger cash portion than others in order to cover the cost of medical care for illness and disability. A mandate which ignores these differences will have negative effects on the operation of the supply-side of the labor market.

In an analogous manner, the demand-side of a labor market will offer compensation bundles which conform to the preferences of the workers who are sought. Firms seeking young, relatively unskilled workers will tend to offer largely cash; firms seeking older, more highly skilled workers will tend to offer retirement benefits and health care coverage, as well as cash wages. Workers sort themselves out among firms as they seek employment; they will search out the compensation bundles that are consistent with their own preferences. Consequently, if a law requires the payment of retirement and health care benefits—at the expense of cash—to young workers, it may prescribe an inefficient compensation package for the young that negatively affects their welfare. If it requires child-care benefits for older workers in excess of their preferences, it may define an inefficient compensation package for them as well.

Mandated standards that are established by law can be predicted to have their most pronounced adverse effects on low-wage, entry-level employment. Of course, all employments, even for professionals, have their points of entry. For lawyers, they may be summer internships as law school students or first appointments as associates in partnership law firms. or physicians, they may be hospital internships while qualifying for medical specialty examinations. But in these cases, earnings are low only with respect to the range of earnings in the respective occupations, with earnings prospects rising as career paths are followed over time, unaffected by the mandate.

Mandates have large adverse effects, however, in employments in which employees are young or part-time, where workers have few—if any—skills and relatively little schooling.

Mandates have large adverse effects, however, in employments in which employees are young or part-time, where workers have few—if any—skills and relatively little schooling, or where employees are immigrants with difficulties in English-language expression. The supply of these labor services is plentiful, relative to the demand for the services that they have to offer. Compensation packages paid to them in unconstrained labor markets would, therefore, be low. But in constrained labor markets, minimum wage laws construct a floor below which cash wages are not permitted to fall. When other laws define benefits that must be included in compensation packages, there is no legal adjustment possible in cash wages. Since these jobs typically carry few other benefits, the effect is to increase total compensation. Consequently, fewer jobs will be available and fewer of these relatively untrained, unschooled, and inexperienced workers will be employed. Occupational points of entry for these workers are virtually closed.

With little training, schooling and few skills, lifetime earnings prospects (for unskilled workers) are not rosy. But employment, even with initially modest compensation packages, improves their lifetime prospects. Even unskilled employment imparts some vocational skill and communicates standards of punctuality, civil and disciplined behavior, and modes of efficient workplace dialogue.

Those who are shut out of employment by the imposition of mandates on the terms of employment lose opportunities for those improvements; their lifetime earnings prospects are consequently diminished.

The disemployment effects of a health care mandate on relatively unskilled workers are accentuated by the variety of mandates which fall most heavily on low-wage labor. Social security, unemployment compensation, and workmen's compensation laws all impose payroll taxes on only an initial fraction of payments for work while exempting higher levels of earnings. The taxes that feed funds for the payment of those mandated benefits, fall disproportionately upon the unskilled. A larger fraction of their earnings is taxed than of those whose earnings are higher.

Mandated Health Care Coverage[1]

Employment based health insurance emerged in World War II, when wage and price controls put constraints on the cash wage increases offered by firms. The expansion of fringe benefits was then propelled by the internal revenue code, which made cash earnings of workers subject to income taxes, but exempted the non-cash components of earnings from taxation.

In the late 1980's, 147 million individuals were covered by employer-sponsored health insurance plans with another 34 million covered by individual private insurance. (Employer-based health insurance often covers employees' dependents as well as the employees themselves.) Additionally, the federal government partially or wholly finances health insurance for most of the elderly through the Medicare program, and for about half of the poor through Medicaid.

Some 39 million Americans are uninsured. Those lacking employer-based health insurance are concentrated among part-time, seasonal and temporary workers, the young, persons with low-income, and workers in retail trade and in the service sector.

The uninsured consume fewer health care services per person and per household. This may be because: the uninsured receive insufficient care; or, the insured receive an excess of care; or, there is systematic bias in the selection of employment so that those who are more likely to require health care make their way into positions in which health care insurance is a component of the compensation package. A combination of all of those conditions is likely to be operative.

The proposed employer health insurance mandate would have effects in the labor market as well as in the market for medical services and health care. After an adjustment lag, the quantity of labor employed will diminish, money wages will be lower, and other fringe benefits will be reduced. These effects will fall disproportionately upon less-skilled, lower wage workers.

In general, workers would prefer to receive the whole of their wages in the form of cash. Cash is an instrument for the acquisition of a wide array of diverse commodities and services that optimizes the purchaser's well-being. In-kind payments, such as health insurance, received at the expense of cash, must be consumed in the form in which they are received or they are lost.

For workers who, if they were paid wholly in cash, would use a portion of their earnings to buy health insurance, the provision of health insurance by their employers as part of their compensation packages might be preferred since employer-based health insurance can be provided more cheaply by employers than if it were bought in the insurance market by individual workers. Whether such workers have this preference depends, of course, on whether employment-based insurance is at least equal in value to what the worker desires to acquire. If workers value cash over the offered benefits package, and if the cash offered is sufficiently large to overcome the transaction costs of purchasing it themselves, even those workers might prefer to receive the whole of their earnings in cash and privately arrange the health care coverage that optimizes their well-being.

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1 For a comprehensive review, see U.S. Department of Labor, Health Benefits and the Workforce (Washington, D.C., Government Printing Office) 1992.

General worker preference for choice in consumption is demonstrated by worker behavior when given the option of larger cash payments or smaller cash payments accompanied by health insurance. Research shows that the young, low-wage earners, part-time workers, and those who "turn over" frequently from firm to firm, predominantly opt out of employer-offered health insurance, when they are granted that option.

Workers who are only weakly risk-averse or who expect to encounter lower-than-average health care costs can also be expected to prefer larger cash payments without health insurance coverage.

When some firms offer pay packages that include health insurance and others do not, workers with these demographic and socio-economic characteristics sort themselves out among firms so that they are concentrated in their employment in firms that pay a large proportion of earnings in cash and a small proportion in in-kind benefits. Firms fashion their pay packages to conform to the preferences of the types of workers they seek to attract. Mandated employer-provided health insurance disadvantages those workers by compelling them to accept payment for their services in what is, for them, a less desirable form.

Research shows that the young, low-wage earners, part-time workers, and those who "turn over" frequently from firm to firm, predominantly opt out of employer-offered health insurance, when they are granted that option.

Thus, payments weighted more heavily towards cash rather than a combination of cash and health insurance are, in part, a response to preferences on the worker-supply side of the labor market.

Conditions on the firm-demand side of the labor market also affect the composition of pay packages. Small firms and those with relatively high labor turnover rates or a large component of part-time workers are less likely to include health insurance in their compensation packages than other firms.

This pattern is mainly due to the unit cost of health insurance, which (both absolutely and in relationship to payroll expenses) is much higher for small firms than for large firms. Health insurance premium payments represent a larger percentage of employee compensation for small firms than for large firms, since small firms are typically more labor-intensive than large firms. Similarly, small firms have lower profit margins and a smaller capacity to absorb higher costs than do large firms.

In addition, the risk pools of small firms are unstable, because of their small size. Small firms, therefore, are less able to self-insure for health insurance than large firms. Self-insurance is cheaper than commercial health insurance because: self-insuring firms retain the investment earnings of contributions until payouts are made; the profit margins of commercial insurers are avoided; and, the Employee Retirement Income Security Act (ERISA) exempts self-insured plans from state regulation of the services the plan must cover.

There is great diversity among firms in the characteristics of their employees. Some specialize in the employment of the young, others the elderly; some employ mainly males, others females; for some, turnover rates are high, for others low. Given that diversity, there is also great variation in the optimum compensation packages among firms. Some find it appropriate to offer health insurance as a component of the package; others do not. For those firms that do offer health insurance, there is much diversity in the nature of the benefit. There is variance in types of treatment covered, dollar ceilings on benefits, percentages of costs paid by the insurance coverer, and deductibles on co-payments paid by employees.

For some workers, such as adult males, a mandate will have little effect on employment but it will reduce their real wages. For other workers—teenagers, young working mother, those close to retirement, those for whom welfare is a close alternative, and those whose wages are at or close to the legal minimum wage—the main effect of mandated health insurance will be reduced employment.

To summarize, the true "costs" of mandated health insurance will entail fewer and smaller fringe benefits, less money wages and less employment. Those costs will fall most severely on less-skilled, lower-wage employees.

Thus, payments weighted more heavily towards cash rather than a combination of cash and health insurance are, in part, a response to preferences on the worker-supply side of the labor market.

In addition, mandated health insurance can be expected to have negative effects in the markets for health care—at least in the short run. Medical care resources—physicians, nurses, paramedical personnel and clinical facilities—will become overburdened as the increment in the insured population and cross subsidies inflate the demand for professional service. An efficient system of care would properly allocate illnesses between self-care and professional care by distinguishing self-correcting illnesses and those that are responsive to self-medication from those that require professional intervention. Because insured individuals and families incur only minor out-of-pocket costs when they have recourse to professional care, health insurance tends to intensify the use of professional services, even for illnesses for which those services are not appropriate. Those services are, of course, drawn away from the treatment of illnesses where they are more essential. The wider the spread of health insurance in the population, the more intense will be the misallocation of professional resources among illnesses.

Primary-care physicians, in a recent year, provided service in 472 million office visits. If only 2 percent of non-prescription drug consumers had sought professional help, rather than relying on self-medication, the number of office visits would have risen by 53 percent to 721 million office visits. Even a trivial movement out of self-care towards professional medical care could swamp the professional care system.

The proposed formation of large insurance risk pools under a mandated health insurance arrangement implies cross subsidies. All individuals in a given risk pool pay the same premium. The larger the pool, the more heterogeneous and the larger the variance in the demands for health care of the pool's members. Thus, in large risk pools, the young will subsidize the health care of the elderly; those with few dependents will subsidize those with many; non-smokers will subsidize smokers; and those of prudent life styles will subsidize the imprudent. Consequently, it is not clear that a public policy mandate for the inclusion of health insurance as a component of all compensation packages would serve a totally benign social purpose.

A Note on Mandated Minimum Wages

Occasionally, published academic papers report empirical findings that a legislated rise in the minimum wage is not followed by reduced employment. These findings primarily have applied to occupations with relatively unskilled labor which is not used in fixed proportions with other resources. This apparent lack of correlation between the price of labor and the quantity of labor employed can be explained by:

- the superfluous rise in the minimum wage, in the sense that the wage earnings in the occupation were already above the increased legal minimum level so that the rise had no effect; or,
- the research on which the papers were based did not permit sufficient time for reduced employment to be shown. Adjustments in labor markets do not occur instantaneously but take, in different occupations, variant—and sometimes long—periods to work themselves out; or,
- effective rises in wages were offset by declines in other components in compensation packages; or,
- changes in other variables outweighed the negative relationship between the price of labor and the quantity of labor demanded.

In the last case, for example, a change in community tastes in favor of the goods and services produced by workers whose wage earnings have been increased by law, may show up empirically as no change in employment as wages rose. But the negative relationship between the rise in the price of labor and the numbers employed in the relevant class will only have been obscured by the changes in other variables that drive the market. The rise in wages will have reduced employment, but that reduction will have been swamped by increased employment for other causes. The finding that no negative effect resulted from an increased minimum wage arises only because the disemployment effects of the rise in the minimum wage were obscured.

Fortunately, few of the researchers who authored these papers have suggested that it was intellectually permissible to extrapolate from their findings to a generalized conclusion that a rise in legal minimum wages would never, in any occupation, have disemployment effects.

> ***Fortunately, few of the researchers who authored these [minimum wage] papers have suggested that it was intellectually permissible to extrapolate from their findings to a generalized conclusion that a rise in legal minimum wages would never, in any occupation, have disemployment effects.***

The overwhelming consensual judgment of the community of economists, expressed in the professional literature of the discipline, is that the regulation of wages by the state is an inefficient instrument for the improvement of the lot of the working poor and that this regulation has adverse effects upon economic performance.

Almost any randomly-selected text in microeconomics will contain at least a few sentences expressing this point of view—the distilled judgment of the profession. The implications of the theory are clear: if the price of labor rises, employers will use less of it. If government enlarges wage costs above those that are experienced in unconstrained competitive markets, less labor will be employed in the industries in which higher wage standards are enforced. Most adversely affected will be low-wage workers, a disproportionate number of whom are young, old or handicapped.

Minimum wage laws also have distributional effects in that they can prevent less skilled workers from competing against more highly skilled workers by precluding these less-skilled workers from offering labor services at a price that makes them competitive. In a similar manner, minimum wage laws protect richer geographic regions from having to compete for jobs with poorer regions, thus diminishing economic activity in these poorer regions. Thus, rather than protecting low-wage labor, minimum wage laws can actually work to exclude less-advantaged workers from the market to the benefit of better-off workers.

A Catalogue of Federal Mandates

The Fair Labor Standards Act of 1938 (FLSA) specifies a minimum wage for a very large fraction of workers. The level of the minimum has been revised upwards from time to time by Congressional action so that it now stands at $4.25 per hour. Proposals have recently been made to raise this to $4.50 per hour in the short run. In addition, these proposals frequently include an automatic structure to replace the *ad hoc* process by which Congress raises the minimum wage with one that links the minimum wage to changes in either other wages in the economy or the price level. In addition, under the FLSA, hours worked in excess of forty per week are required to be compensated at a rate that is one-and-one half times the worker's regular rate of pay. Moreover, some kinds of work—notably sewing of apparel—may not be done legally in an employee's home without the prior approval of the United States Department of Labor. There are constraints on the hours of work and on the kinds of work that may be done by young people under 16 and there is an enumeration of hazardous work that may not be done by young people under 18.

By virtue of the Employee Retirement Income Security Act (ERISA) of 1974, plans established by employers to provide retirement or deferred compensation benefits for their employees or to provide welfare benefits—such as health, disability, death and vacation benefits, scholarships, day care for children, apprenticeship and training benefits, or prepaid legal services—are subject to regulatory control by the government. The government sets minimum mandated standards for the administration and, to some extent, the structure of benefit plans. Through ERISA, the operation of a million pension plans and of four-and-a-half million plans providing other benefits are regulated. The regulations affect funding standards, age and service eligibility standards, qualification for vesting credits, disclosure of information to participants, and spousal rights to benefits.

It has long been American policy that only citizens of the United States and aliens authorized to work in this country may be legally employed. Now, employers are required to verify the eligibility for employment of persons that they hire.

Under the Occupational Safety and Health Act (OSHA) of 1970, health and safety conditions in employment are regulated. Explicit standards are defined that cover hazards like falls, explosions, radiation, noise, electricity, fires, chemical exposure, exposure to asbestos, cave-ins, and vehicle operation and maintenance. Exposure to health hazards is controlled by regulations that define appropriate work practices and engineering controls and that require the use of personal protection equipment. If an explicit standard has not been composed, a "general duty" requires that "a place of employment (be) free from recognized hazards that are causing or are likely to cause death or serious physical harm to...employees." The federal statute and the standards issued under it apply to 51 million employees in 3.6 million places of work. An additional 32 million employees in 3 million worksites are covered by state-administered programs approved by a federal government agency. Every employer with one or more employees is covered.

Thus, rather than protecting low-wage labor, minimum wage laws can actually work to exclude less-advantaged workers from the market to the benefit of better-off workers.

Additionally, standards of health and safety in employment are enforced by judicial decisions that define the liability of employers under the common law of tort. Over recent decades, the courts have tended to extend the rule of strict liability and hold employers responsible if accidental harm occurs at the workplace, without examining whether imprudent behavior by the employer or the employee was the cause of the harm. Where a negligence rule has been applied to determine employer liability—that is, when the prudence of the behavior of those at the workplace has been examined—the courts have often expanded the definition of negligent behavior by employers. As a consequence, many employers carry commercial liability insurance coverage while others self-insure. For those carrying commercial insurance, premium rates have risen as a consequence of the expanded court decisions; for the self-insured, risks of payouts have increased. Thus, the changes in court decisions have enlarged the costs incurred by employers in employing workers.

Additional mandates set percentages of payroll which must be paid by employers to provide workers with retirement income, with hospital care for the elderly, with compensation during unemployment, and for disability caused by accidents at work.

In general, employers now must provide sixty-day advance notice for plant closing and large-scale dismissals of employees under the Worker Adjustment and Retraining Notification (WARN) Act.

The Americans with Disabilities Act (ADA) of 1989 requires that employers make "reasonable accommodations" for disabled workers, including job restructuring and modified or part-time work schedules. "Reasonable accommodation" includes, explicitly, readers, sign interpreters, and attendants for travel of the disabled. "Disability" is defined as "a physical or mental impairment that substantially limits...major life activities." The test for employer discrimination against the disabled, as specified in the Act, is "disparate impact." The burden of proof that a qualification of being able-bodied is appropriate for proper work performance falls upon employers.

Under the Family and Medical Leave Act of 1993 (FMLA), firms with fifty or more workers are required to provide their employees with up to twelve weeks of unpaid leave during any twelve month period for family medical emergencies, childbirth, or adoption and foster care proceedings. The leave may be taken intermittently or by reducing the normal daily or weekly work schedule. Upon return from this leave, the employee must be restored to the same, or an equivalent, job without reduction of pay, benefits, or other terms of employment. Health insurance and other benefits may not be suspended during leave periods.

Specialized mandates of various kinds apply—through the wording of various pieces of legislation—to the terms of employment of migrant and seasonal agricultural workers, handicapped workers, miners, transit workers, airline workers, trucking employees, employees of federally-funded contractors, veterans, and longshore and harbor workers.

The National Labor Relations Act (NLRA) mandates that the terms of employment be bargained collectively with trade unions representing workers when a majority of workers desire to be so represented. Collective bargaining significantly affects the terms of employment, since higher wages are a goal of most union activities.

The Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 mandates that employees who have health insurance coverage through their employment may continue to buy health insurance through their employers for a period of eighteen to twenty-nine months after termination of their employment at a cost to the employee of 102 percent of the premium previously paid by the employer or jointly by the employer and employee. Only a small fraction of eligible terminated employees elect to take continuation coverage and, by an adverse selection process, those who do are likely to consume medical care more intensely than the average for the group for which the premium rates were calculated.

The Findings of the Minimum Wage Study Commission

The Minimum Wage Study Commission was created by the Congress in 1977 and issued its report in 1981.[2] It employed the services of professional staff and outside contractors to examine the effects of minimum wage laws. Among the findings of those professionals, the following appear:

- "Increases in the current or near-future federal minimum wage appear to depress current employment in certain industries that probably have a high proportion of minimum wage workers and among teenagers, the demographic group that has the highest incidence of minimum wage workers."

2 United States Minimum Wage Study Commission, Report (Washington, D.C. Government Printing Office, 1981, 7 volumes.

- "A minimum wage that covered all workers will cause a large (probably intolerable) amount of unemployment in the long run."
- The increase in federal minimum wages in 1974 diminished the gross domestic product, and wage and salary employment, in the years immediately following the increase.
- Both time-series and cross-section research results are broadly consistent "with the basic received economic theory which holds that increases in the federally mandated minimum wage result in decreased employment."
- An investigation of the effects of federal minimum wage legislation in a low-wage state (South Carolina) concluded that a 20 percent increase in the minimum wage makes approximately 81 percent of minimum wage workers in South Carolina worse off than before the change. "Large disemployment effects due to minimum wage increases were found."
- "In private non-farm employment, and in manufacturing, services and retail trade [the three industries in which there are sufficient numbers of young employees to enable useful estimates to be produced], [there is] a significant negative relation between the effective minimum and relative employment...If anything,...the previous work has underestimated the impact of the minimum wage (on youth disemployment)."
- "If there were no minimum wage, the number of out-of-school young men who are employed would be more than 6 percent higher than it is now"; "the average wage paid to youth...is lower with the minimum than it would be without it."
- "Both the minimum wage rate and Fair Labor Standards Act coverage reduce the mean earnings for those with low education and (presumable) skill levels...There is practically no evidence that minimum wage rate provisions increase the earnings of (improve) the poverty position of the least educated...Moreover, there is some evidence that these provisions increase unemployment and nonparticipation...The (usually stated) rationale or goal of the minimum wage system is to help the working poor receive a higher income. Our results suggest that this goal generally is not met and indeed that the system often harms the groups who are the intended beneficiaries...Thus the minimum wage policy appears to be a poor policy with effects that often have been misunderstood or misrepresented."
- "The additions to household income produced by increasing the minimum wage are spread quite evenly across the distribution of household income. Households in the lower half of the distribution receive only about one half of the total "benefits" of this policy. In terms of the share of total benefits accruing to low-income households, the minimum wage compares unfavorably with government transfer programs...Increasing the minimum wage redistributes income within income classes as well as across income classes. More than 80 percent of low-income households are harmed by the minimum wage."

- "Inasmuch as there is not a strong correlation between individual earnings and family income—with large numbers of minimum wage workers found among households at all income levels—the message from the body of empirical evidence is that the minimum wage has had small "beneficial" effects on the distribution of income. There are, however, other mechanisms which would be *more effective* in providing income support for individuals and families, such as direct federal government transfer payments or some variant of a negative income tax. (Italics added)."

In summary, the findings of the research sponsored by the Minimum Wage Study Commission were consistent with those of previous professional literature. A legal minimum wage and increases in the levels of the legal minimum wage are not effective instruments for the improvement of the conditions of life of the country's working population. Such laws serve to: depress employment in industries in which low-wage workers and young people are concentrated; reduce economic output, reduce employment in manufacturing, services, and retail trade; reduce the earnings of young people and those with low levels of skill; and, distribute income in an inequitable manner.