The Heritage Foundation Backgrounder

No. 675 | The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002-4999 (202) 546-4400

October 6, 1988

MANDATED BENEFITS: THE HIDDEN TAX HIKE THAT DESTROYS JOBS

INTRODUCTION

Congress can be very creative. When taxpayers begin resisting spending, Congress finds ways of disguising the true cost of programs. One favorite method has been to move programs "off budget," so that they do not even appear in the federal budget. In this way taxpayers may be fooled into believing that these programs are "free."[1] Another means of disguising spending is for Congress to move spending into the credit portion of the budget. By this the federal government guarantees private lending to projects or individuals, usually at below-market rates.[2] By insuring the over $450 billion worth of private sector loans, Congress has found a way to provide benefits to certain constituencies without appearing to spend money. Of course, loan guarantees are a commitment to spend money later if borrowers default. This is a very real and expensive possibility, as taxpayers are now discovering with the proposed $50 billion taxpayer bailout of the Federal Savings and Loan Insurance Corporation.

Congress's newest form of budget subterfuge is perhaps the most dangerous. This takes the form of avoiding direct federal spending by forcing business to provide the service instead, at its own cost. In each case, firms are required to give certain groups money or benefits that cannot be justified on commercial grounds. In this past session of Congress over ten separate "employee mandated benefit" laws have been proposed or enacted, with a total potential price tag to businesses of $40 billion to $120 billion a year.

Examples: Congress passed legislation this summer requiring businesses to provide 60 days notice to employees before closing a plant. Legislators also barely failed to enact a steep increase in the minimum wage and broad expansions to the Davis-Bacon Act, which

1 Thomas J. DiLorenzo, "Putting Off-Budget Federal Spending Back On the Books," Heritage Foundation *Backgrounder* No. 406, January 30, 1985.

2 John E. Buttarazzi, "Selling the Federal Loan Portfolio," in Stephen Moore and Stuart M. Butler, eds., *Privatization: A Strategy for Taming the Federal Budget* (Washington, D.C.: The Heritage Foundation, 1987).

requires businesses winning federal contracts to pay union wages. Lawmakers ran out of time to act on the most expensive and intrusive measure of all: Senator Ted Kennedy's legislation mandating employers to provide health insurance for all workers. Now in the final days of the session, the Senate appears likely to consider legislation to force companies to provide paid parental and medical leave to their workers. Whatever mandated benefit legislation fails this year no doubt will be a top priority when the 101st Congress convenes in January.

Harming Small Businesses. The cruel trick of mandated benefits, of course, is that the true cost ultimately is borne by consumers in the form of higher prices, by workers in the form of lower wages and destroyed jobs, and by the federal Treasury in the form of reduced tax revenues from a slower growing economy. The businesses that are harmed most, moreover, are small and minority-owned firms, which have been the primary job creators over the past decade.

Many legislators clearly believe that by forcing business to become a checkbook for the welfare state, they have discovered the ultimate "free lunch." In truth, Americans gain no free lunch when businesses are forced to absorb the cost of government programs.

Endangering 1-2 Million Jobs. The biggest loser from mandated benefit laws is the group that is supposed to be helped most: American workers. By forcing American firms to add billions of dollars to their labor costs, the proposed bills undermine U.S. international competitiveness and could torpedo the current economic expansion, causing a hemorrhage of American jobs. In Europe, where mandated benefits are common, jobs have not grown for nearly a decade and unemployment is at double-digit rates, as mandated benefits push up the cost of labor. In the U.S., an estimated one million to two million jobs would be lost if all the mandated benefit bills were enacted.

Mandating employer benefits is nothing more than a method of forcing Americans to pay indirectly for social welfare programs that they refuse to pay for directly through higher taxes. Ronald Reagan repeatedly has pledged to veto any congressional tax increase. Now he must declare his intention to veto any of these back door taxes that are sent to him in the final days of this session. Then next January, after Inauguration Day, the new President should warn Congress that he will veto any bill that contains such a back door tax hike.

THE PROLIFERATION OF MANDATED EMPLOYEE BENEFITS

This year more than ten separate bills were introduced in the Senate and House that would force companies to provide certain benefits to their employees.[3] These bills comprise the biggest labor agenda before Congress since the New Deal. Some of these bills, such as plant closing notification legislation, have already been passed. Others, such as parental leave, may yet pass Congress this session. Others still, such as minimum wage, have been blocked or seem stalled. But even if they fail this session, the pending bills will be top priority in the new Congress.

---

3 William H. Peterson, "Six Bills Penalizing Working Americans," Heritage Foundation *Issue Bulletin* No. 133, October 7, 1987.

Among the most important pending bills are:

1) Parental and Medical Leave

The Senate version of the Parental and Medical Leave Act requires businesses of 20 or more workers to provide employees who become parents of new-born children with 10 weeks of unpaid leave. The bill covers fathers and mothers. Businesses also would be mandated to give seriously ill employees up to 13 weeks of unpaid leave. The Senate may vote this week on the legislation.

Economic Impact: Robert R. Nathan Associates, a Washington economic consulting firm respectedfor careful analysis,[4] estimates the cost to businesses for added health insurance costs alone would be between $200 million and $600 million per year.[5] The General Accounting Office places the cost at $350 million each year. The American Society for Personnel Administration (ASPA) believes that the most significant cost to businesses of the legislation would be the expense of hiring temporary replacement workers. ASPA estimates the average cost to a business of lost productivity and the direct expense of recruiting and training a temporary worker for a low-skilled position at about $11,200.[6]

2) Mandated Employee Health Care

Senator Edward Kennedy, the Massachusetts Democrat, introduced legislation this year to require employers to provide employees working over 17.5 hours a week — and their dependents — with specified health insurance coverage. This insurance would include in-patient and out-patient care by physicians and hospitals, prenatal and baby care. Though the legislation was reported out of the Senate Labor and Human Resources Committee, no further action is expected this year. It is likely to be pushed hard next year by liberals in both Houses.

Economic Impact: Nathan Associates puts the first year cost to American business of the Kennedy legislation at a staggering $35.8 billion annually.[7] The Congressional Budget Office (CBO) places the cost at $27 billion per year.[8] The Washington-based Institute for Research on the Economics of Taxation estimates that the increased insurance demand ignited by the bill would raise total health insurance costs by $100.8 billion per year.[9] This

---

4 In January 1988, Nathan Associates conducted a series of studies on the estimated cost of various mandated benefit proposals. The studies were commissioned by the National Foundation for the Study of Employment Policy. The Foundation believes that the eventual cost of these bills could be twice as high as the studies indicate.

5 Robert R. Nathan Associates, "The Private and Public Sector Costs of Proposed Family and Medical Leave Legislation," 1988.

6 American Society for Personnel Administration, "Replacement Costs and Operational Difficulty of Implementing Family/Parental and Medical Leave Legislation," 1988.

7 Robert R. Nathan Associates, "The Private and Public Sector Costs of Proposed Mandated Health Insurance for All Workers," 1988.

8 Statement of Edward M. Gramlich, Acting Director, Congressional Budget Office, before the U.S. Senate Committee on Labor and Human Resources, November 4, 1987.

9 Aldona Robbins and Gary Robbins, "Mandating Health Insurance," Institute for Research on the Economics of Taxation *Economic Policy Bulletin*, July 1987.

would increase the budget deficit by $35 billion a year, thanks to increased Medicaid and Medicare costs sparked by a rise in medical costs, and would lead to the elimination of one million jobs.

3) High Risk Occupational Disease Prevention

This legislation would require firms to offer health monitoring and testing to current and former employees who are, or have been, exposed to hazardous substances in the work place. If the worker has suffered injury due to exposure, the employer must offer the worker a new job at the same salary level, or pay the worker his salary and medical insurance for one year. The firm would be forced to pay for these benefits even if the workers were fully informed of the health risk and were already compensated for this risk through a higher salary. This legislation passed in the House, but was defeated in the Senate.

Economic Impact: A Nathan Associates analysis places the cost to businesses of this at between $5.8 billion and $6.4 billion per year.[10] The most costly feature of the legislation is anticipated litigation expenses due to liability claims. The American Society for Personnel Administration predicts that "a landslide of litigation would result if the bill were enacted into law."[11]

4) Anti-Double Breasting for Construction Companies

Legislation introduced in the House and Senate would bar "double breasting," which is the technical term describing when a construction company allows unionized firms to form nonunion affiliates to compete in local market conditions. Similarly, it means a construction firm can maintain a more costly unionized division, making it eligible for government contracts without having to pay the same artificially high wages throughout its operations. The anti-double breasting bill effectively mandates union membership and union rates for much of the construction industry. The legislation has passed the House and is pending in the Senate.

Economic Impact: No studies have examined the direct costs to businesses of the legislation. But an analysis by Thompson, Mann, and Hutson, a Washington-based law firm, estimates that more than 100,000 construction workers now in nonunion affiliates could be forced into union membership by the anti-double breasting act.

5) Davis-Bacon Act

The 1931 Davis Bacon Act requires private contractors to pay "prevailing wages" to employees working on all federally funded construction projects with a value of over $2,000. Proposed amendments to the Davis Bacon Act would expand its application to sub-contractors, suppliers of raw materials and components used on federal construction sites, and to all projects that are built privately but leased to the government. One version

---

10 Robert R. Nathan Associates, "The Private and Public Sector Costs of Proposed Occupational Risk Legislation," 1988.
11 "Hazard Communication for Non-Manufacturing Employees," American Society for Personnel Administration *Legal Report*, Spring 1988, p. 4.

of this legislation was passed in the House as an amendment to the original Defense Authorization Bill, but was defeated in the House-Senate conference.

Economic Impact: Davis-Bacon Act requirements inflate the cost of federal construction projects by approximately $1 billion annually.[12] No estimates have been made of the cost of expanding the law to subcontractors.

6) Raising the Minimum Wage

Several bills have been introduced to raise the minimum wage above its current level of $3.35 per hour. These bills would force employers to pay low-skilled workers higher-than-market wages. The version recently brought to the Senate floor would raise the current minimum wage by 40 cents an hour each year for three years, bringing it to $4.55 an hour. This bill died following a filibuster. It is likely to be introduced again in some form next year.

Economic Impact: The United States Chamber of Commerce estimates that raising the minimum wage would cost American business $4 billion per year.[13] The President's Council of Economic Advisers calculated last May that an increase in the minimum wage would cost consumers $13 billion per year in higher costs of products. There is wide disagreement over the extent of potential job losses because firms reacted to minimum wage hikes by laying off lower-skilled workers. The Congressional Budget Office estimates that some 350,000 workers would lose their jobs, while Nathan Associates put job losses at as many as 800,000.[14]

OVERALL ECONOMIC IMPACT OF MANDATED BENEFIT LAWS

Table 1 summarizes the potential economic costs of the four most burdensome mandated benefit bills currently before Congress. If this entire catalog of legislation were to be passed, the total cost to consumers and businesses would range between $40 billion and $120 billion. As many as 2 million jobs could be lost as a result of the increased cost in hiring and retaining workers.

In addition to the overall price tag of the mandated benefit agenda, these laws impose other costs on society that proponents tend to overlook. Among them:

---

12 Congressional Budget Office, *Modifying the Davis-Bacon Act: Implications for the Labor Market and the Federal Budget,* 1983.

13 U.S. Chamber of Commerce, "Increasing the Federal Minimum Wage Rate," 1987.

14 Robert R. Nathan Associates, "The Impact of Increasing the Minimum Wage on Employment in Retailing," 1988.

TABLE 1
THE OVERALL ECONOMIC IMPACT OF FOUR MANDATED BENEFIT LAWS

LEGISLATION	ANNUAL COST TO BUSINESSES/CONSUMERS	JOBS LOST
Mandated Health Insurance	$30 - $100 Billion	1 Million
Parental Leave	$200 - $700 Million	unknown
Minimum Wage	$4 - $13 Billion	90,000 - 800,000
Occupational Disease Notification & Testing	$5.8 - $6.4 Billion	unknown
TOTAL COST		
Low Estimate	$40 Billion	1.1 Million
High Estimate	$120 Billion	over 1.8 Million

Source: Nathan Associates.

Small and minority businesses are hurt most.

Since 1980, Fortune 500 companies have shed 1.6 million workers from their payrolls, while small businesses have added over 16 million employees. Yet mandated employee benefits legislation is primarily an assault on the job-creating small business sector, not big corporations. Most large, established firms already provide many of the benefits that would be mandated by law. For instance, the parental and medical leave legislation would affect almost only small businesses, because an estimated 95 percent of all Fortune 500 companies already provide this benefit.[15] The same is true of health insurance. More than 98 percent of businesses with over 100 workers offer health coverage, while only 45 percent of firms with fewer than ten employees do.[16] In fact, one vocal proponent of the Kennedy health insurance bill, Robert L. Crandall, President of American Airlines, Inc., openly admits that one of his main objectives in supporting the bill is to saddle his smaller competitors with the same health insurance compensation costs that his own firm faces.[17]

Small businesses suffer most from mandated benefit laws because the cost per worker of complying with such laws is higher for small firms than their larger competitors. According

15 Frances Shaine, Statement of the Chamber of Commerce of the United States on "Parental and Medical Leave Act of 1987," Senate Committee on Labor and Human Resources, February 19, 1987.

16 Frank S. Swain, Small Business Administration, Letter to Senator George Mitchell, July 25, 1988.

17 Quoted in "Notable and Quotable," *The Wall Street Journal*, August 8, 1987, p. 16.

to the Small Business Administration, the administrative costs associated with a fringe benefit package tends to be greater for small businesses because they typically experience more rapid labor turnover rates and hire more part-time and seasonal workers. In addition, there are economies of scale in providing fringe benefits. Because of their smaller risk pool, for instance, small firms pay about 40 percent higher health insurance premiums than large businesses.[18]

Almost all the nation's small business groups, including the half-million member National Federation of Independent Business (NFIB), strongly oppose the government mandating employee benefits. In fact, the 1986 "White House Conference on Small Business" ranked opposition to mandated benefits as the number two priority of the small business community.

Minority small businesses in particular would be hard hit by mandated employee benefits legislation. Ralph C. Thomas, executive director of the National Association of Minority Contractors, complains that the Davis-Bacon Act "is poison to minority contractors. The law's prevailing wages are often too high for the minority contractor to afford. The law also stifles the minority contractors' efforts to hire as many minority workers as possible."[19]

Mandated benefits hurt, rather than help, American workers.

Most supporters of mandated benefits concede that laws such as the minimum wage do lead some low-skilled workers to lose their jobs. But these supporters contend that the alleged benefits to the rest of the work force outweigh the cost to those whose jobs are eliminated. Yet almost all workers lose when the government mandates minimum benefits. The reason is that when specific benefits are required by law, businesses respond by trying to reduce other aspects of their total labor bill.[20]

The Congressional Budget Office acknowledges this. In its analysis of the mandated health insurance legislation, for instance, the CBO writes:

> Employers would almost certainly strive to minimize the impact [of the Kennedy Bill] on profits. Because raising prices would reduce sales of their products, affected employers would probably adopt this strategy only to the extent that they could not shift costs to their employees. The shift could be accomplished by limiting wage increases, by reducing fringe benefits of other types than health insurance, or by cutting the quantity of labor employed. Because most of the workers who would be affected receive little or no compensation in the form of fringe benefits, the long run effect would be to lower wages

18 Swain, *op. cit.*
19 National Association of Minority Contractors, " Minority Contractors Support Davis-Bacon Reform," Press Release, August 15, 1986.
20 The best general discussion of this is in Richard B. McKenzie, *The American Job Machine* (New York: Universe Books, 1988).

by about the amount of the employer's required contributions.[21]

Minimum Wage Costs. Several studies on the impact of the minimum wage confirm that workers suffer through reductions in other forms of compensation. Ohio State economist Masanori Hashimota reported in the *American Economic Review* that after the 1967 increase in the minimum wage to $1.40 an hour, the take-home pay of workers rose by 32 cents an hour, but the value of per-hour training for minimum wage workers fell 41 cents an hour. This means these workers lost 9 cents an hour.[22]

Other studies find that minimum wage hikes lead to net overall losses in pay and fringe benefits, thanks to cutbacks in such benefits as severance pay, sick pay, year end bonuses, and vacation time.[23]

When the government locks in minimum levels of benefits, workers also lose the flexibility to choose their fringe benefits. For instance, a 1986 survey of 700 firms by the National Chamber Foundation finds that 77 percent have formal or informal parental leave policies for their workers. Of the 23 percent that do not have such a policy, almost three-fourths said they do not offer parental leave because their employees have indicated they preferred other benefits. Thus, if the federal government compels these firms to provide parental leave at the expense of other fringe benefits, the workers would not be able to receive the package of benefits they preferred.

MANDATED BENEFITS AND U.S. INTERNATIONAL COMPETITIVENESS

The lesson of foreign countries that have introduced minimum employee benefit requirements is that this form of hidden taxation impedes job creation and deters businesses from locating within their borders. The 1988 report of Ronald Reagan's Council of Economic Advisers concludes that by enacting mandated benefit laws, many European nations have sacrificed a degree of international competitiveness. States the report: "European governments have realized that the inflexibility of labor markets due to job security mandates, along with a variety of other labor market interventions, have impaired growth in the employment sector and spawned high unemployment rates."[24] Saddled with double-digit unemployment rates, the report adds, some West European countries have even begun to repeal job protection and mandated benefit laws.

Over the past two decades U.S. businesses have enjoyed a distinct competitive edge over many of America's major trading partners. The reason for this is that the U.S. economy is less burdened by labor market rigidities. This means that U.S. firms have been better able to adapt to changing economic conditions and thus to take advantage of new opportunities. This advantage will be lost, say many economists, by mandating employee benefits and job

---

21 Gramlich, *op. cit.*, p. 11.
22 Masanori Hashimota, "Minimum Wage Effect on Training on the Job," *American Economic Review*, December 1982, pp. 1070-1087.
23 Belton M. Fleisher, *Minimum Wage Regulation in Retail Trade* (Washington, D.C.: American Enterprise Institute, 1981).
24 Council of Economic Advisers, *Economic Report of the President*, 1988, pp. 195-196.