

# Background

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## Should Federal Labor Policy Be Any Different After the 2005 Hurricane Season?

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Federal policymakers are now considering many proposals to assist the hundreds of thousands of workers displaced by Hurricanes Katrina, Rita, and Wilma.<sup>1</sup> Many policies have merit, especially those that utilize the effectiveness of market forces by getting governmental bureaucracy and regulations out of the way. For example, using executive authority, President George W. Bush suspended labor regulations under the Davis–Bacon Act within a few days after Hurricane Katrina hit. But that move proved short-lived, and many of the plans being considered for evacuees are likely to be counterproductive.

Congress should avoid policies that will not only delay workers from returning to work, but also exacerbate unemployment.

- *First*, President Bush’s Worker Recovery Accounts may be problematic in their final form.
- *Second*, concentrating evacuees in mobile home camps will likely worsen unemployment.
- *Third*, most displaced workers simply need a place to work, not new skills or redundant training.

The situation in the Gulf Coast region is changing rapidly, and the high level of confusion and complexity is ripe for exploitation by government regulators. Now is the time to scale back big-spending bureaucracy and let the free market work.

As usual, however, those who are skeptical of the free market are pointing to inflated price spikes—for housing, for water, even for gasoline—as symbols of a broken process, even though the price mechanism is

### Talking Points

- Congress has an opportunity to fashion a labor policy in response to recent hurricanes along the Gulf Coast that utilizes market incentives rather than trying to “fix” the broken communities through direct, expensive federal action.
- Congress should begin by securing stable homes for evacuees in real communities. Plans for artificial FEMA communities are likely to worsen the humanitarian situation.
- Worker Recovery Accounts could be failed job-training programs in new packaging. Most of the displaced cooks, barbers, photographers, bartenders, cashiers, accountants, and taxi drivers of New Orleans and Biloxi do not need the new set of skills such training would offer but still might be tempted to enroll just to receive the benefits.
- Congress should realize that the existing Unemployment Insurance system is working well to cushion job losses. On the other hand, the Davis–Bacon reversal is a setback for labor market freedom.

This paper, in its entirety, can be found at:  
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working precisely as it should. High prices send signals to suppliers that this is a profitable market, and no signal could be clearer than the very high wages being offered to workers in New Orleans. The tragedy of Katrina, Rita, and Wilma is certain to be amplified if a bureaucratic federal government tries to “fix” everything instead of trusting private entrepreneurial activity to accomplish the job.

## Displaced Workers Need Jobs, Not New Social Programs

During his first major address to the nation following Hurricane Katrina, the President called for creation of a new federal program, Worker Recovery Accounts (WRA). These accounts are based on Personal Reemployment Accounts in the Job Training Improvement Act of 2005 (H.R. 27).<sup>2</sup>

At first glance, individual cash accounts, or WRAs, for workers seem to offer more flexibility than traditional unemployment insurance. WRAs would provide up to \$5,000 for displaced workers to seek career counseling, job training, child care, transportation expenses, and other services. Individuals should be able to use the money as they see fit and to keep whatever amount remains when they find a job. However, WRAs have yet to be legislated and may suffer from bureaucratic rules, in which case the program ultimately authorized could end up resembling something more like repackaged job training.

Policymakers should be concerned that the WRAs’ job-training components could make the current unemployment situation worse, not better. For example, WRAs could create an incentive for formerly employed workers to delay reentry into the workforce by requiring them to enroll in government training programs in order to qualify for cash benefits. Most of the displaced cooks, barbers, photographers, bartenders, cashiers, accountants, and taxi drivers of New Orleans and Biloxi do not

need the new set of skills that such training would offer but still might be tempted to enroll just to receive the benefits.

One conservative objection to WRAs—even if implemented as an employment incentive—is that they may well create incentives to game the system. In principle, an individual is qualified for a re-employment account only if unemployed, say for a week or more. WRA creates a perverse incentive for workers to request that they be officially laid off by their employers, if only for the time needed to qualify for the WRA. Even employers planning to keep everyone on payroll at a new facility will be tempted to offload the team at the government’s expense during the transition.

Consequently, the WRA is vulnerable to spending that not only is massively excessive, but also does not flow to those truly in need. Considering that 2.5 percent of the U.S. workforce changes jobs every month voluntarily, a fully exploited *national* WRA could cost up to \$15 billion per month in unneeded expenditures alone.<sup>3</sup>

Finally, re-employment accounts have been proposed as an alternative to unemployment insurance, not as an add-on. Aside from the fact that redundant spending is wasteful, the whole point of re-employment account reform was to change the incentives from an entitlement mentality to an ownership mentality. By simply adding on WRAs, the government will get the worst of both. The former system will continue to encourage workers to *stay* unemployed, while the new system will encourage them to *become* unemployed.

If Congress lacks the capacity to repeal unemployment insurance (UI) in the region in exchange for a reformed WRA system, then it should do nothing and allow the functioning UI program to continue working.

1. The Congressional Budget Office estimates that between 280,000 and 400,000 people lost jobs directly because of Hurricane Katrina. See Congressional Budget Office, *The Macroeconomic and Budgetary Effects of Hurricanes Katrina and Rita: An Update*, September 29, 2005, p. 7, at [www.cbo.gov/ftpdocs/66xx/doc6669/09-29-EffectsOfHurricanes.pdf](http://www.cbo.gov/ftpdocs/66xx/doc6669/09-29-EffectsOfHurricanes.pdf).
2. H.R. 27 was passed by the House of Representatives on March 2, 2005. The House of Representatives is waiting for the Senate to act on its job-training legislation.
3. Authors’ calculations based on Census data from the Current Population Survey.

## Housing Policy Will Shape the Employment Outcome

Perhaps the most important labor policy of all is not directly related to the labor market. The fundamental crisis for evacuees is housing, and the location of housing is also the foundation upon which individuals will base their employment decisions. The housing remedy for hundreds of thousands of evacuees will have a greater impact on their employment than anything else.

Regrettably, the Federal Emergency Management Agency (FEMA) went on a “spending spree” in early September, buying half a billion dollars’ worth of mobile homes from one manufacturer alone,<sup>4</sup> a big-government solution that is likely to exacerbate the humanitarian crisis if evacuees are forced into those shelters, as some Members of Congress intend. There are no jobs in artificial communities because there is no market either for goods or for the employment behind provision of those goods.

The important principle to keep in mind is that every displaced worker is a displaced consumer. Evacuees will add to the consumption demands of communities where they reside: higher demand for food, for clothing, and for services. Consequently, evacuees should be located in areas that already have the private-sector infrastructure to supply the goods and services they need and that will respond in kind with demand for new workers. But this

market process can function only if evacuees are housed in real communities as opposed to shelters.

Plans to house evacuees in camps or movable living units are destined to fail, as The Heritage Foundation’s housing expert, Dr. Ronald Utt, explained recently.<sup>5</sup> Housing vouchers, on the other hand, are a bipartisan solution that would empower individuals to live in housing that is already on the market. This makes even more sense in light of a current national vacancy rate of 10 percent.<sup>6</sup>

By contrast, the “FEMA city” of 500 isolated trailer homes in Punta Gorda, Florida, that is home to families displaced by Hurricane Charley a year ago provides a cautionary tale.<sup>7</sup> This camp has no employment opportunities and essentially alienates its occupants from society in countless ways. A month into the recovery effort, there were 100,000 evacuees stuck in shelters and an estimated 200,000 living in hotels.<sup>8</sup>

## Job Training Is Ineffective

The Worker Recovery Accounts rely too much on job-training programs that have a history of failure.<sup>9</sup> This is blamed too frequently on managerial problems without any consideration of the possibility that government-funded training is fundamentally flawed.<sup>10</sup> Federal job-training programs have gone through successive congressional “reforms,” ranging from the Manpower Development and Training Act (MDTA) of 1962 to the Workforce Investment Act (WIA) of 1998. All were

4. Spencer S. Hsu and Elizabeth Williamson, “Housing Promises Made to Evacuees Have Fallen Short,” *The Washington Post*, October 2, 2005, p. A1.
5. Ronald D. Utt, Ph.D., “After Weeks of Confusion, the Right Course for Evacuee Housing Assistance,” Heritage Foundation *WebMemo* No. 866, September 28, 2005, at [www.heritage.org/Research/SmartGrowth/wm866.cfm](http://www.heritage.org/Research/SmartGrowth/wm866.cfm) (October 3, 2005).
6. U.S. Bureau of the Census, Housing Vacancy Survey 2nd Quarter 2005, July 28, 2005, at [www.census.gov/hhes/www/housing/hvs/qtr205/q205prss.pdf](http://www.census.gov/hhes/www/housing/hvs/qtr205/q205prss.pdf) (October 24, 2005).
7. Marc Kaufman, “FEMA’s City of Anxiety in Florida,” *The Washington Post*, September 17, 2005, p. A1, at [www.washingtonpost.com/wp-dyn/content/article/2005/09/16/AR2005091601922.html](http://www.washingtonpost.com/wp-dyn/content/article/2005/09/16/AR2005091601922.html) (October 3, 2005).
8. Jacqueline L. Salmon and Spencer S. Hsu, “A Big Cut in Katrina’s Hotel Bill,” *The Washington Post*, October 19, 2005, p. A8.
9. David B. Muhlhausen, “Congress Spends Billions on Ineffective Job-Training Programs,” Heritage Foundation *Background* No. 1597, October 1, 2002, at [www.heritage.org/Research/Labor/bg1597.cfm](http://www.heritage.org/Research/Labor/bg1597.cfm); David B. Muhlhausen, “Do Jobs Programs Work? A Review Article,” *Journal of Labor Research*, Vol. 26, No. 2 (Spring 2005), pp. 299–321; and David B. Muhlhausen and Paul Kersey, “In the Dark on Job Training: Federal Job-Training Programs Have a Record of Failure,” Heritage Foundation *Background* No. 1774, July 6, 2004, at [www.heritage.org/Research/Labor/bg1774.cfm](http://www.heritage.org/Research/Labor/bg1774.cfm).
10. Gordon Lafer, *The Job Training Charade* (Ithaca, N.Y.: Cornell University Press, 2002).

intended to overturn past failures by instituting new administrative restructuring, all the while funding the same ineffective job-training programs.

The current job programs funded under WIA bear a striking resemblance to the job-training programs funded under the Job Training Partnership Act (JTPA) of 1982.<sup>11</sup> Similar programs funded under JTPA have been found to be largely ineffective.<sup>12</sup>

Three types of JTPA activities were evaluated by Abt Associates, one of the world's largest for-profit government and business research and consulting firms, in a 1996 study: classroom training, on-the-job training, and job-search assistance. "Other services" tailored to participants on the basis of their age were evaluated as well.<sup>13</sup> These programs were found to be ineffective at raising the incomes of adult males or of male and female youths: Only the "other services" elements appear to have had a sustainable positive impact on adult women. In addition, these programs failed to increase the wages of participants. This outcome indicates that—in the opinion of employers—JTPA did not increase the skills of participants.

Current federal job-training programs are based on such failed programs of the past. The Government Accountability Office (GAO) estimates that 78 percent of Workforce Investment Act job training participants partook of occupational classroom training.<sup>14</sup> Occupational classroom training has been demonstrated to be ineffective at raising the incomes of participants.<sup>15</sup> The federal government should not encourage displaced workers to participate in programs that will not only fail to raise their incomes, but also delay their return to work.

Further, the GAO found that nearly two-thirds (65 percent) of the local boards that run WIA programs failed to keep performance data regarding which providers serviced job trainees most effectively.<sup>16</sup>

Congress faces considerable uncertainty about the effectiveness of WIA programs because there has been no reliable assessment either of WIA or of the system of "one-stop" employment service centers it created. If Congress is modeling its hurricane relief job program after WIA without knowing whether the program actually works, it is legislating in the dark. In the 1998 Work Investment Act, Congress mandated that the Labor Department conduct a multi-site impact evaluation of WIA by September 2005, using random assignment and control groups to assure an accurate measurement of WIA's effects. Seven years later, the Department of Labor let this deadline pass without even funding the evaluation.

### What About Unemployment Insurance?

Despite the flurry of new proposals emanating from Congress, the nation already has a major program in operation to assist displaced workers. Unemployment Insurance typically provides \$20 billion per year in benefits, and more during times of need (\$43.3 billion during the "jobless recovery" of 2002).<sup>17</sup> While the UI program is not perfect and needs reform, it operates effectively and automatically to cushion the blow of any economic shock by providing compensation to unemployed Americans for a full six months.

Currently, UI is working as intended. During a normal week, there are around 325,000 new job-

11. *Ibid.*

12. Larry L. Orr, Howard S. Bloom, Stephen H. Bell, Fred Doolittle, Winston Lin, and George Cave, *Does Training for the Disadvantaged Work? Evidence from the National JTPA Study* (Washington, D.C.: Urban Institute Press, 1996).

13. *Ibid.*

14. U.S. Government Accountability Office, *Workforce Investment Act: Substantial Funds Are Used for Training, but Little Is Known Nationally About Training Outcomes*, GAO-05-650, June 2005, p. 17.

15. Orr *et al.*, *Does Training for the Disadvantaged Work?*

16. U.S. Government Accountability Office, *Workforce Investment Act*, p. 4.

17. *2004 Green Book: Background Material and Data on the Programs Within the Jurisdiction of the Committee on Ways and Means*, Committee on Ways and Means, U.S. House of Representatives, 108th Cong., 2nd Sess., March 2004, p. 4-3, at <http://waysandmeans.house.gov/Documents.asp?section=813>.

less claims. In September, however, initial claims spiked. For the first time in two years, initial weekly jobless claims exceeded 1.6 million, some 363,000 of them directly related to Katrina.

But the recent rise needs to be kept in perspective. Jobs are constantly lost in a dynamic economy, which is never a problem in the macro sense so long as job creation is vibrant. The government's role in job creation is to provide a stable environment in terms of physical security, property protection, and law enforcement. Government becomes a hindrance to private-sector job creation when it imagines itself a direct employer (through spending or through coordination) or if it overextends labor rules in such a way that stifles private sector activity.

### Red Tape in Davis–Bacon

The Davis–Bacon Act is a 1931 law that requires federal construction contractors and subcontractors to pay so-called prevailing wages. In practice, this usually means the union wage. Immediately after Katrina struck, President Bush suspended prevailing wage rules in the areas with severe damage, as the Act allows in times of emergency and following in the tradition of President Franklin Delano Roosevelt.<sup>18</sup> Then, on October 26, President Bush gave in to congressional pressure and officially agreed to reinstate the law as of November 8, 2005, exactly two months after its suspension. This reversal will cause more harm than good by increasing the cost of rebuilding communities hit by the hurricanes.

Davis–Bacon was passed by Congress at a time before price controls were known to be economic poison and makes little sense in light of modern economics. The fact that it has not been fully repealed attests to the remaining power of labor unions, which can use the law to extract concessions from big employers. And, of course, the setting of prevailing wages requires a platoon of government statisticians, working under the assumption that they can outsmart the market by taking backward-looking medians and averages of wages in different occupations.

AFL–CIO warnings that wages would collapse as a result of the President's initial repeal proved empty. Instead, wages were rising, and construction firms—finally freed from unnecessary red tape—were actually calling for more workers. The fact that this did not stop over 200 House Members from threatening to repeal the President's Davis–Bacon order simply shows once again that politics trumps economics.

Nevertheless, it remains true that laws that amount to meddling in the free market add no value to business or workers, despite their pretense. In a new century when legislators should know better, laws like the Davis–Bacon Act and the McNamara–O'Hara Service Contract Act of 1965, which establish government-enforced price controls on labor, are simply indefensible.

### What Congress Should Do

The U.S. government's response to the job devastation caused by Hurricanes Katrina, Rita, Wilma, and others this season should not be based on the typical paradigm of trying to protect workers. Instead, the government should help to create an environment that gives employers the opportunity to grow.

The instinctive reflex that government can help by offering job training is misplaced. Relying on private entrepreneurial activity, instead of bureaucratic government, must be the focus of helping displaced workers. Thus, the federal response should be to (1) help displaced workers first settle into real communities; (2) help them find employment; and (3) avoid perverse incentives that leave individuals perpetually dependent on government programs.

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18. Ronald D. Utt, Ph.D., "President's Bold Action on Davis–Bacon Will Aid the Relief Effort," Heritage Foundation *WebMemo* No. 836, September 9, 2005, at [www.heritage.org/Research/Labor/wm836.cfm](http://www.heritage.org/Research/Labor/wm836.cfm).