Backgrounder
No. 2624
November 16, 2011
Published by The Heritage Foundation

Unintended Consequences: Allowing the Unemployed to Sue Would Destroy Jobs

James Sherk and Andrew M. Grossman

Abstract: *With a high unemployment rate and a struggling economy, passing legislation that discourages job creation would seem counterintuitive. And yet, by pushing for the Fair Employment Opportunity Act (FEOA) this is precisely what President Obama and some Members of Congress propose. The FEOA would define the currently unemployed as a "protected class," and allow them to sue for discrimination in hiring. Little evidence exists that employers discriminate against the unemployed. Letting unemployed workers sue, however, would raise the cost of creating new jobs—each unemployed applicant would become a potential lawsuit. Businesses would respond by creating fewer new jobs and relying more heavily on existing networks to fill positions. The FEOA would make it harder for unemployed workers to find jobs. Good intentions are not enough to negate the law of unintended consequences.*

President Barack Obama has proposed legislation that would allow the unemployed to sue prospective employers for alleged "hiring discrimination." Such a law would discourage hiring and hurt the very workers it purports to help. By exposing businesses to more legal threats, it also would put a drag on the economy.

Employers create a new job when the benefits of hiring a worker exceed the costs. By exposing employers to legal risk, the proposed law would raise costs and discourage businesses from hiring. Good intentions are not enough to ensure good outcomes. Congress

Talking Points

- The President and some in Congress have proposed allowing unemployed workers to sue employers that discriminate against them in hiring.
- This is a problem in search of a solution. Few employers refuse to consider hiring unemployed workers. Just one in 10,000 help-wanted ads express a preference for hiring the currently employed.
- Allowing lawsuits would enable trial lawyers to bring frivolous suits and pressure employers into settling. Even diligent employers would face substantial legal liability. These higher costs would discourage job creation.
- The fear of a lawsuit would cause businesses to want nothing to do with the unemployed. Employers would turn to informal networks instead of public advertisements to fill vacancies.
- Good intentions do not prevent harmful unintended consequences. Congress should not make it more difficult for the unemployed to find work in a tough economy.

This paper, in its entirety, can be found at:
http://report.heritage.org/bg2624

Produced by the Center for Data Analysis

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

The Heritage Foundation
LEADERSHIP FOR AMERICA

should not make it more difficult for unemployed Americans to find work.

Fair Employment Opportunity Act

Long-term unemployment—defined as unemployment for 27 weeks or more—continues to impede America's economic recovery. Over 6 million Americans are now long-term unemployed, while a million more, having dropped out of the labor force due to their inability to find suitable work, are classified as "discouraged."

The President and some Members of Congress argue that the problem of long-term unemployment is in part the result of discrimination by employers against individuals without jobs. This charge has been fueled by media reports that some businesses are advertising positions that are open only to the currently employed. These reports are based on a few "help wanted" advertisements mentioning employment status as a qualification and hardly constitute conclusive evidence. Indeed, a report by the left-wing National Employment Law Project found only 150 such ads out of the millions of listings on major job-listings Web sites.[1]

Nevertheless, some Members of Congress have proposed legislation to combat this alleged epidemic of discrimination against the long-term unemployed. Entitled the Fair Employment Opportunity Act (FEOA), this new legislation defines the currently unemployed as a "protected class," just like racial minorities, the disabled, and other groups. In addition to making the unemployed a protected class, the FEOA would:[2]

- Prevent employers from considering whether or how long a worker has been unemployed when making hiring decisions, except for cases "where an individual's employment in a similar or related job for a period of time reasonably proximate to the hiring of such individual is a bona fide occupational qualification reasonably necessary to successful performance of the job that is being filled";
- Prohibit employment agencies from considering a workers' employment status when screening applicants;
- Ban help-wanted ads that express a preference for the currently employed, even where current employment would be a "bona fide occupational qualification";
- Prohibit "retaliation" against employees who make claims under the FEOA or support others' claims;
- Permit workers who believe they have been discriminated against to sue prospective employers in state or federal court;
- Permit class actions on behalf of unemployed job-seekers against prospective employers who allegedly take employment status into account in making employment decisions; and
- Permit the Department of Labor to investigate allegations of discrimination and to bring lawsuits against employers for alleged discrimination, seeking both money damages and changes in employment practices and policies.

President Obama has embraced the FEOA and included it in his new stimulus and jobs legislation. While the President and the Members of Congress supporting this bill may be acting with the best of intentions, such good intentions do not negate the law of unintended consequences: The FEOA would make it more difficult for the unemployed to find work, thereby further prolonging America's full economic recovery.

A Solution in Search of a Problem

The stories of legions of job ads warning that the "unemployed need not apply" are unfounded. When these reports first appeared, the online job-search engine Monster.com reviewed the ads posted on its

1. National Employment Law Project, "Hiring Discrimination Against the Unemployed: Federal Law Outlaws Excluding the Unemployed from Job Opportunities, as Discriminatory Ads Persist," *Briefing Paper*, July 12, 2011, at *http://www.nelp.org/page/-/UI/2011/unemployed.discrimination.7.12.2011.pdf?nocdn=1* (November 8, 2011).
2. Fair Employment Opportunity Act of 2011, H.R. 2501, 112th Cong., 1st Sess. The bill covers businesses with 15 or more workers.

site. The company found that less than one one-hundredth of 1 percent—1 in 10,000—of its job ads excluded the unemployed.[3] Very few companies refuse to hire the unemployed; after all, such a restrictive hiring policy would make little business sense. Excluding the unemployed from consideration would mean ignoring many talented workers. Additionally, unemployed workers are often more flexible about wages than those with jobs are.[4] Refusing to consider hiring individuals without jobs would unnecessarily raise business costs.

These reports of discrimination against the jobless suggest that employers might bypass the unemployed over concerns that the longer individuals are out of work, the more their job skills deteriorate. The data do show that workers who have spent more time out of work are less likely to find a job than those who were more recently laid off.[5] However, the primary reason for this disparity is that some workers—such as those with more specialized skills—take longer to find new work than others. As those more likely to find a job return to work, the pool of long-term unemployed shifts toward workers who take longer to find jobs.[6] Employer concern over skill erosion does little to explain the lower job-finding rates of the long-term unemployed.

Furthermore, research shows that employers are quick to hire those jobless individuals whose unemployment occurred as the result of corporate bankruptcy or layoffs—as opposed to individuals who were terminated.[7] Employers do not assume that just because an individual is unemployed, he or she is a poor performer; clearly, many look more closely at the applicant in question. The FEOA is a solution in search of a problem.

A New Burden on Job Creators

It is counterintuitive, at the very least, to assume that raising the cost of job creation will encourage the creation of more jobs. Yet this assumption is at the core of the FEOA. Specifically, the FEOA would impose costs on all businesses employing 15 or more individuals in at least four ways:

1. **The cost of assessing legal obligations.** Complying with employment law is expensive. To follow the law and avoid legal risk, employers create written practices and policies for every step of hiring, and many consult with attorneys to ensure that their written plans comply with every aspect of these rules. For the same reasons, human resources personnel and managers frequently receive training on their legal obligations and what they may and may not discuss with job candidates lest they risk exposing the business to liability. Employers would have to supplement their existing policies and practices to incorporate the FEOA's new requirements.
2. **The cost of legal uncertainty.** In addition to the widespread economic and regulatory uncertainty facing American businesses, these companies would now face new legal risk as the Department of Labor and the courts gradually work out the details of FEOA compliance. The legislation, as drafted, leaves unanswered numerous critical questions that would arise in practically every hiring situation. For example:
   - May employers require job candidates to have a certain number of years of experience, which would necessarily tend to favor those who are employed and building experience?

3. Monster.com, "Updated: Monster Speaks Out Against Employment Discrimination," *Monster Thinking*, August 31, 2011, at *http://www.monsterthinking.com/2011/08/31/monster-speaks-out-against-employment-discrimination/* (November 8, 2011).
4. Nicholas M. Kiefer and George R. Neumann, "An Empirical Job-Search Model, with a Test of the Constant Reservation-Wage Hypothesis," *Journal of Political Economy*, Vol. 87, No. 1 (February 1979), pp. 89–107.
5. Andreas Hornstein, Thomas Lubik, and Jessie Romero, "Potential Causes and Implications of the Rise in Long-Term Unemployment," Federal Reserve Bank of Richmond, *Economic Brief* No. EB11-09, September 2011, at *http://www.richmondfed.org/publications/research/economic_brief/2011/pdf/eb_11-09.pdf* (November 8, 2011).
6. *Ibid.* See also Andreas Hornstein, "Accounting for Unemployment: The Long and Short of It," Mimeo, Federal Reserve Bank of Richmond, September 2, 2011.
7. Robert Gibbons and Lawrence Katz, "Layoffs and Lemons," *Journal of Labor Economics*, Vol. 9, No. 4 (October 1991), pp. 351–380.

- Is such a qualification—which is in some respects arbitrary, given that not all years of experience are created equal—a "bona fide occupational qualification"?
- How can an employer demonstrate that any particular requirement that co-occurs with current employment—for example, being up on the latest techniques, having experience with the latest version of a software package, having references who are currently in the industry—is a "bona fide occupational qualification," as opposed to an arbitrary requirement that is not strictly necessary for a particular position?
- May employers take account of how a person has used his or her time out of work? For example, is the individual in question writing a book or watching back-to-back episodes of a sitcom?

3. **The cost of potential liability.** Because these questions are unsettled, and because the FEOA offers generous money damages to successful plaintiffs, employers will face a flood of lawsuits, including class actions, by unsuccessful job applicants alleging discrimination. Such routine practices as requiring a resume and current references may provide the basis for at least a *prima facie* case of discrimination, opening the door to discovery and the burden of litigation.

   Discovery, in turn, may open the door to "disparate impact" cases, in which the burden shifts to an employer to demonstrate the necessity of any requirement that results in a statistical difference in hiring between different classes of candidates—in this case, the employed and the unemployed. In such cases, the employer's motive, good or bad, is immaterial; all that matters is the statistical difference and his ability to explain it. In other words, the burden is on the employer to demonstrate why, for example, he wanted a programmer with four years of experience with some recent technology and not one with two years or experience or one with no experience but a good attitude.

4. **The cost of extortion.** Naturally, uncertain or highly technical legal standards, combined with money damages for violation, make it attractive for plaintiffs and plaintiffs' attorneys to bring "strike suits" of uncertain or little legal merit with an eye toward coercing a settlement from the would-be employer without the need for litigation. One recent example of this phenomenon is teams of lawyers and professional plaintiffs bringing thousands of lawsuits against small businesses in California for minor Americans with Disabilities Act violations, which only California allows to be the subject of private suits for damages.[8] The FEOA is ripe for just this sort of abuse; consequently, this legislation amounts to a direct tax on job creation—only the proceeds would go to trial lawyers instead of the government.

Injuring the Unemployed and the Economy

Employers search for new employees to fill vacant jobs when the expected benefits from making a new hire exceed the costs.[9] The Fair Employment Opportunity Act raises the cost of filling job vacancies. As a result, many businesses that could hire would decide that attempting to fill vacancies was not worth the risk of getting sued. The end result: fewer new jobs.

The FEOA would also make it more difficult for unemployed workers to apply for existing job openings. A business would face the greatest risk of a lawsuit when unemployed workers who are unknown to them—potentially working with trial lawyers—applied for jobs. Therefore, many employers would minimize this risk by not permitting unknown workers to apply in the first place.

Business owners already use informal networks such as family, friends, and other personal contacts

8. See, e.g., American Tort Reform Foundation, "Judicial Hellholes 2010: California," at *http://www.judicialhellholes.org/california_2010-11/* (November 8, 2011).
9. Dale Mortensen and Christopher Pissarides, "Job Creation and Job Destruction in the Theory of Unemployment," *Review of Economic Studies,* Vol. 61 (1994), pp. 397–415.

to locate new employees.[10] They fill many jobs without posting a single public "help wanted" ad. The FEOA would encourage businesses to rely even more heavily on these informal channels. Without a public job listing, unknown workers could not apply for an open position—or sue for not being hired. While this would reduce businesses' liability risks, it would also make it much more difficult for unemployed workers without good professional or personal networks to find work.

No less troubling is the damage that an artificial increase in hiring through private contacts could do to the economy. The reason that employers rely on public listings, which cost money and can entail significant search costs, is that it gives them access to a larger pool of talent and higher-quality workers than they would be able to find by narrower means. If employers are forced to forsake these benefits to avoid legal risks, their businesses too would suffer. And if businesses suffer, the U.S. economy suffers.

More Unintended Consequences

Exposing employers to legal liability for posting job vacancies would discourage them from hiring or posting vacancies. Congress should learn from its past mistakes. In 1990, Congress passed the Americans with Disabilities Act to protect disabled workers from discrimination, but employment rates among the disabled fell after the ADA took effect. Several studies have found that, by imposing expensive burdens on employers that hired disabled workers, the ADA caused these job losses.[11] Ultimately, a law intended to help the disabled prevented many disabled Americans from finding jobs.

The FEOA may also impose a similar, although unintended, consequence on jobless individuals. For instance, as a natural consequence of the act, employers would refuse to discuss current employment status with prospective employees; such a discussion might, after all, be used against them in subsequent litigation. If employers are unwilling to ask detailed questions about the criteria that matter to them—such as whether an individual who has been out of work has maintained good work habits or acquired new skills—they may assume the worst, and the prospective employee will be unable to dispel those assumptions.

Again, this is not a hypothetical risk. Several studies indicate, for example, that employers who check criminal backgrounds are more likely to hire minorities at high statistical risk of criminal involvement than employers who do not check criminal backgrounds.[12]

Good intentions do not repeal the law of unintended consequences. If Congress wants to help unemployed workers find jobs, then it should not make hiring such workers a risk for employers.

A New Tax on Hiring

The Fair Employment Opportunities Act is a solution in search of a problem. Little research or evidence suggests that employers exclude the unemployed when hiring. Consequently, there is no policy justification for the creation of new legislation that would expose employers to considerable legal risks when making a new hire. In fact, these legal risks are far more substantial than with other antidiscrimination laws because employment status is tied up with so many of the usual, legitimate factors considered by an employer that practically any hiring process could result in a lawsuit. As a result, even employers who attempted to follow the law diligently could not avoid the risks and expense of strike suits by plaintiff's lawyers.

10. Cees Gorter and Jos van Ommeren, "Sequencing, Timing and Filling Rates of Recruitment Channels," *Applied Economics*, Vol. 31, No. 10 (1999), pp. 1149–1160.
11. Daron Acemoglu and Joshua D. Angrist, "Consequences of Employment Protection? The Case of the Americans with Disabilities Act," *Journal of Political Economy*, Vol. 109, No. 5 (October 2001), pp. 915–957; Thomas DeLeire, "The Wage and Employment Effects of the Americans with Disabilities Act," *Journal of Human Resources*, Vol. 35, No. 4 (2000), pp. 693–715.
12. See, e.g., Harry J. Holzer *et al.*, "Perceived Criminality, Criminal Background Checks, and the Racial Hiring Practices of Employers," *Journal of Law and Economics*, Vol. 49 (2006), p. 451; Michael Stoll, "Ex-Offenders, Criminal Background Checks, and Racial Consequences in the Labor Market," *University of Chicago Legal Forum*, Vol. 1 (2009), p. 381.

As a result of the costs associated with these risks, the FEOA would constitute a *de facto* tax on hiring. Businesses would create fewer new jobs and rely more heavily on informal networks to hire. The Fair Employment Opportunities Act would make it harder for the unemployed to find work.

*—**James Sherk** is Senior Policy Analyst in Labor Economics in the Center for Data Analysis, and **Andrew M. Grossman** is a Visiting Fellow in the Center for Legal & Judicial Studies, at The Heritage Foundation.*