Research

Principles for Better Labor Market Policy

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Overview

It is no secret that the U.S. labor market has struggled in the aftermath of the Great Recession. The unemployment rate has remained elevated, labor force participation is at 30-year lows, and real wage growth has been missing in action. There are good reasons to focus policy efforts on improving the performance of the labor market. What principles should guide this effort?

- *Do No Harm*. The labor market does not need mandates that make workers more expensive and reduce job growth.
- *Build a Work-friendly Social Safety Net*. The choice should never be government support or work. Government support should be the path to work.
- *Improve Skills in the Labor Force*. Higher education standards can fuel the achievement that equips U.S. students to earn more and compete more successfully.

I elaborate on each below.

1. *Do No Harm*

Don't raise the federal minimum wage. Raising the minimum wage is not the route to either less poverty or faster job growth. Why not? After all, increasing the minimum wage to $10, or even $15, would ensure that millions of Americans got raises; raises that they would presumably turn right around and spend.

Yes, if the money came out of thin air. It does not; indeed it may be the result of not hiring another poor American. Of course not every dollar will come from not hiring low-wage workers. But every dollar will have to come from somewhere. A minimum wage hike also means higher prices, lower raises for other workers, or fewer dividends for seniors, IRA holders, and pension funds. Low-wage workers may pay those higher prices, blue-collar workers are desperately clinging to their pensions, and seniors need their dividends to make ends meet. There is simply no guarantee that the resources are transferred from the well-to-do to the presumed deserving. And the diminished resources of those harmed by the minimum wage hike offset the spending of the beneficiaries.

Even if it does not produce growth, wouldn't an increase alleviate poverty? No, as it does not target those in poverty. Only two percent of workers are paid the minimum wage, and only 0.4 percent of works make the minimum wage *and* are in poverty. The reality is that the dividing line between being poor and being non-poor is having a job. Only 7 percent of those who have a job are in poverty, while the number jumps to over 20 percent among those not working.

Even worse, the minimum wage does not *help* anyone get a job. There is mixed evidence that past minimum wage increases have led to layoffs, but recent research indicates that hiking the minimum wage would harm new hiring. That's not good labor market policy.

Stop the Affordable Care Act (ACA) damage to the labor market. The ACA's employer mandate is a disincentive for hiring; combined with regulatory burdens and new taxes the net effect will be to limit the ability for firms to grow. The ACA will also lead to a greater reliance on a part-time workforce, as companies will not be mandated to provide health insurance benefits to part-time workers. These workers will thus have to make do with a reduced income or balance multiple part-time jobs.

The employer mandate impacts hiring and employees' hours because it requires employers with 50 or more full-time employees (100 or more in 2015) to provide health insurance and carries a specific, per-employee fine for noncompliance. The financial impacts to those that do not provide coverage or for firms that are looking to hire the 50th worker are clear. For example, a 49-employee firm that does not provide coverage and elects to hire their 50th employee now faces a fine of $40,000 per year, which is the $2,000 per employee penalty above the first 30 employees. A small firm can skirt this requirement by switching to part-time workers.

In addition, complex reporting requirements exist that are less obvious, but add paperwork and costs nonetheless. Even for companies that currently provide coverage and will continue to do so, the mandate requires disclosure of their employees' salaries and health insurance coverage; including the names and Social Security numbers of employees and family members who are eligible, what the insurance covers, and the cost to the employee of the different plans offered. While employers are reporting relief that the mandate will begin in 2015 (or 2016 for smaller firms), a delay only temporarily lessens the burden of health reform. It does however, make it more likely that employers who were already contemplating dropping health insurance benefits and shifting employees onto the exchanges will do so, which is, in essence, additional advertising for the exchanges.

Furthermore, the law includes a health insurance tax on all plans, an excise tax beginning in 2018 on plans deemed overly generous (the "Cadillac tax"), and mandates that small group plans cover a comprehensive list of "essential benefits". All of these will result in higher benefit costs for employers. This reduces firms' ability to pay adequate wages, increase their labor force, and invest in their business. AAF recently found evidence that the ACA has resulted in reduced pay and employment in small- and mid-size businesses. The ACA is yet another reason firms may stop providing benefits and instead increase monetary compensation.

Finally, the ACA defines full-time work as more than 30 hours a week; far below the conventional 40-hour definition. This is a strong incentive for employers to shift toward the use of part-time workers to avoid having to provide health insurance.

2. Build a work-friendly Social Safety Net.

The ACA is an example of a safety net program that damages work incentives (see the Congressional Budget Office). At a time when labor force participation is already declining in part due to the aging of the population, a premium should be placed on preserving or improving the incentives to work in the social safety net.

Reform Social Security Disability Insurance (DI). The DI program provides monthly income to non-elderly adults who have worked in the past, but who are unable to work due to a serious medical condition. The DI program faces severe financial pressures, but reforms should minimize inappropriate incentives to enter the program and provide appropriate exits from DI back to work.

Among the options are to increase the work history requirements, restrict vocational qualifications, and extend the benefit waiting period. Under current law, to qualify for benefits workers must have worked at least 5 years, with 5 of the total required working years having occurred in the prior 10. It would be possible to require more, and more recent, years of work in order to qualify. This would directly increase the work incentives.

An important determinant in DI eligibility standards is the degree to which an individual may find other work. These standards become less restrictive for older age ranges. As the population ages and there are more older potential workers, it may make sense to have these remain more restrictive and encourage work.

Finally, to qualify for DI benefits, eligible recipients must have earnings below a threshold amount for 5 months during which time they receive no benefits. In order to reduce incentives for entry to DI, one could lengthen this to 12 months. Of course, disabled workers would still receive retroactive benefits for the waiting period.

Expand the Earned Income Tax Credit (EITC). The main policy towards low-income working families is the EITC. The EITC has a strong track record of promoting work and effectively targeting poverty. At present, however, it provides little support (a maximum of $496) for single men and women without children. One possibility, then, is to expand the EITC for single individuals and thereby improve their work incentives. (An alternative is my PRO wage proposal.)

3.Improve Skills in the Labor Force

Business leaders represented by organizations such as the U.S. Chamber of Commerce and the Business Roundtable agree that higher standards are "critical to building and maintaining an American workforce that can compete in the global economy." Better standards are needed to produce the science, technology, engineering, and mathematics (STEM) education to meet the demands of these high-paying jobs. However, with waning support for implementing initiatives like the Common Core, many states are choosing to take no action to increase standards –or worse, revert to inferior standards.

This is a policy mistake. As far back as 2007, Eric Hanushek, a Senior Fellow at Stanford's Hoover Institute, demonstrated that quality of education is causally related to economic outcomes and that individual earnings are systematically related to cognitive skills. This was again reinforced in 2013 when he wrote in the Wall Street Journal that raising student test scores in this country, up to the level in Canada, could dramatically increase economic growth. Associated additional growth could add an average 20 percent to the paycheck of every worker.

To achieve the required level of quality educational attainment needed for our students to meet the demands of a modern workforce, state policymakers need to focus on elevating educational standards. With the passage of No Child Left Behind Act in 2001, Congress insisted that all children could achieve; now nearly 13 years later the time has come to insist that all children can achieve at a higher level.