

Incentives to Encourage More Worker Friendly Corporations in California

Eric A. Nilsson, Ph.D.
Department of Economics
California State University, San Bernardino
enilsson@csusb.edu

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EXECUTIVE SUMMARY

This report describes and analyzes policies that California can implement that will lead to more “worker friendly” businesses in the state. Worker friendly businesses provide to their employees the following: fair compensation, employment security, healthy and safe working conditions, and employee relations that provide basic workers’ rights.

As requested, the policies proposed in this report are—for the most part—based on incentives such as tax credits and monetary grants. Other policy tools, however, are recommended when they are highly effective for the intended purpose.

This report finds that the most effective ways to promote worker friendliness are to raise the wage floor, reverse the decline of unions, and raise the social standards by which businesses are judged. Narrowly targeted incentives can also promote worker friendliness.

Raising the wage floor is particularly important. A higher wage floor would permit more workers to earn a fair level of compensation. In turn, the most effective way to raise the wage floor is to boost the minimum wage significantly. An increase in the minimum wage, however, cannot be characterized as an “incentive.”

An alternative, incentive-based policy is to provide a grant to local communities that covers the cost of establishing and implementing living wage laws. This will lead to a slight increase in the wage floor in the local communities affected and more workers will be paid a fair level of compensation than before.

Employer-provided healthcare can be promoted by providing a tax credit to employees in small businesses who have not previously purchased healthcare insurance. Additionally, an outreach program should be established to inform small employers of relatively low-cost healthcare insurance plans available through the Health Insurance Plan of California. Many small employers are still unaware of HIPC.

Pension coverage can be promoted by vocal support for federal initiatives to establish a low-cost and simple defined benefit pension plan. The pension plan proposed by the Clinton Administration is superior to any now available to small businesses. An outreach program should also be established to inform small employers of existing low-cost and simple pension plans.

Employment security can be effectively promoted by changing the unemployment insurance tax rate schedule for businesses. This schedule can be altered to reduce the tax rate for businesses that lay off few employees and increase the tax rate for businesses that lay off many employees.

Worker friendly employee relations can be promoted by providing a tax credit to employers who submit their employee handbook to the Department of Industrial Relations. The DIR would make these employee handbooks public. Numerous beneficial consequences will follow. For instance, workers will be better able to find employers with good employee relations. More important, the public disclosure of employee relations policies will force many businesses to improve their employee relations in order to attract the best workers.

Union workplaces are worker friendly workplaces. Unions gain for their members higher wages, better healthcare insurance and pension plans, greater employment stability, healthier and safer workplaces, and a higher likelihood of fair treatment from their employer. Unions can be promoted in two ways. First, the state can provide a tax credit to employers who voluntarily accept their workers’ petition for union representation. Second, state tax credits can be made available only to businesses that do not violate existing state and federal labor laws.

POLICY RECOMMENDATIONS

This report makes 9 policy recommendations. They are:

- Provide a grant to local communities to cover the cost of establishing and implementing living wage laws.
- Provide a tax credit to employees in small businesses who buy employer-provided healthcare insurance for the first time.
- Establish an outreach program to inform small businesses about the existing Health Insurance Plan of California.
- Strongly support federal initiatives to create low-cost and simple defined benefit pension plans designed for small businesses and establish an outreach program to inform small businesses about existing low-cost and simple pension plans.
- Change the unemployment insurance tax rate schedule to provide a greater incentive for businesses to avoid layoffs.
- Continue to improve workplace health and safety conditions by targeting willful violators of existing health and safety laws and by ensuring that ergonomic standards are implemented.
- Provide a tax credit to businesses that submit their employee handbook to the Department of Industrial Relations.
- Provide a tax credit to businesses that voluntarily accept their workers' petition for union representation.
- Provide state tax credits only to businesses that do not violate existing state and federal labor laws.

INTRODUCTION

This report describes and analyzes policies that California can implement that will lead to more “worker friendly” businesses in the state. The characteristics of worker friendly businesses are described below.

As requested, the policies I propose in this report are—for the most part—based on incentives such as tax credits and monetary grants. I recommend using other policy tools, such as outreach programs, where these tools are highly effective for the intended purpose.

THE RISE AND DECLINE OF WORKER FRIENDLY BUSINESSES

Worker friendly businesses provide to their employees:

- Fair compensation,
- Employment security,
- Healthy and safe working conditions, and
- Employee relations that provide basic workers’ rights.

The period from the end of World War II until the 1970s has been called the “golden age” of capitalism in the United States. During this time, compensation grew rapidly, employment generally become more secure, workplace health and safety conditions improved, and a growing number of workers gained basic workers’ rights. In short, worker friendliness was on the rise.

The 1970s was a turning point. From the late 1970s to the 1990s, workers’ standards of living fell as employment compensation grew more slowly than did inflation. The proportion of businesses providing employment security and basic workers’ rights slipped starting in the 1980s. Health and safety conditions stopped improving; along certain

important dimensions, such as ergonomic safety, they might have actually worsened. In short, worker friendliness was on the wane.

Fair Compensation

Between 1948 and 1977, real hourly compensation for production workers grew by 70 percent.¹ Real hourly compensation measures the buying power of one hour of labor after taking account of the eroding effects of inflation. This increase in real compensation caused a dramatic improvement in workers' standards of living.

Since 1977, however, compensation for many workers failed to keep up with inflation. Real hourly compensation for production workers is now more than 10 percent smaller than it was two decades ago.

Both components of compensation—real earnings and real benefits—have declined. Hourly earnings, primarily from wages and salaries, declined in real terms by about 10 percent since the 1970s. Hourly benefits—primarily employer-provided healthcare insurance and pensions—declined by 20 percent in real terms over the past two decades.

Employment Security

Years of “downsizing” during good economic times have taken their toll. Many workers now believe that no matter how hard they work—and no matter how profitable their employer is—they could lose their jobs at any time.

¹ Production workers, which includes 80 percent of the labor force, excludes those classified as supervisors. Compensation, earnings, and benefit data presented in this section come from Nilsson (1999).

The empirical evidence supports this perception. During the 1990s, workers were more likely to be laid off than in recent decades. A recent Federal Reserve study shows that worker concerns about being laid off are as great now during economic good times as they once were during recessions (Aaronson and Sullivan 1998).

Healthy and Safe Working Conditions

Improvement in workplace health and safety has slowed, or stopped, in recent years. Although workplaces along some dimensions are as safe now then they have ever been, flagrant violations of workplace health and safety laws still occur with disturbing regularity. Further, repetitive motion injuries to workers have become increasingly common as new technologies have been introduced into the workplace. Each year repetitive motion injuries force more than 50,000 California employees to miss work. Many of these injuries are crippling and permanent. Workplaces are still not safe enough.

Worker Friendly Employee Relations

Surveys show that employees value employee relations that grant them basic workers' rights.² Two key characteristics of such worker friendly employee relations are:

- A set of rules—fair, formal, and enforceable—governing employee relations within the business, and

² The results of two recent surveys are reported in Business Week and Skota and Aiper Associates (1995) and Freeman and Rodgers (1999).

- A workplace organization giving employees the ability to communicate their suggestions and complaints to management and to influence workplace decisions that directly affect employees.

The early part of the postwar years saw a rise in basic workers' rights. An increasing number of workers were covered by union contracts that provided these rights, businesses were seeking ways to improve their employee relations, and new laws—along with court interpretations of existing laws—expanded workers' rights in the workplace.

In recent years, though, many businesses have reasserted the doctrine of employment-at-will, a concept inherently at odds with workers' rights. A smaller proportion of workplaces provide basic worker rights than once was the case (Edwards 1993; Gordon 1996). As expressed by Freeman and Rodgers (1999, 23), “Workers have a clear notion of what constitutes a good employer, and many found their business falling short of this notion.”

UNDERLYING CAUSES AND GENERAL SOLUTIONS

The parallel decline at the same time of so many aspects of worker friendliness suggests that these declines might all have been caused by some common set of detrimental economic and social changes. I consider these underlying causes here. Once I identify the major underlying causes, I will be able to suggest the most effective policies for reversing this multidimensional decline in worker friendliness.

Underlying Causes

Many forces lay behind the decline in worker friendliness. Some are unique to one particular aspect of the decline. For instance, the rise in prescription drug costs has increased the cost of healthcare insurance for both businesses and employees while a separate

phenomena—the widespread introduction of personal computers in the workplace—lays behind the sharp increase in repetitive motion injuries.

Three trends, however, have had widespread detrimental effects on worker friendliness. I will consider each in turn.

The Fall of the Wage Floor

The wage floor has declined significantly in recent decades. In particular, the real value of the federal minimum wage—which sets the lowest legal wage rate for most workers in the nation—declined by almost 30 percent between the late 1960s and 1999. The decline in the wage floor for California workers over this period was “only” 20 percent because the state recently increased its minimum wage above the federal level.

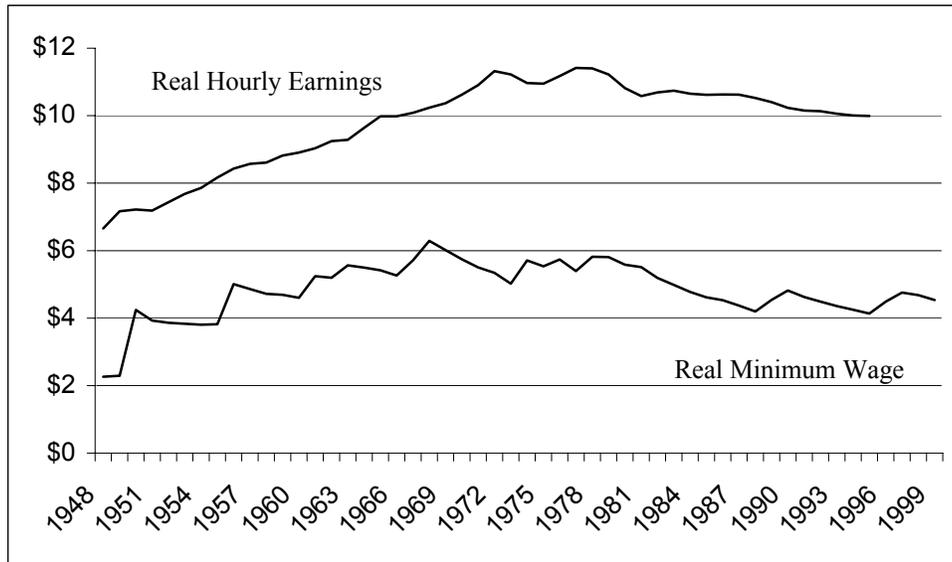
If the California wage floor in 2000 was boosted back to its 1968 level, 3 million workers in California—20 percent of the work force—would receive wage increases.³ Some have argued that one-half the decline in the real earnings of workers after 1977 was due to the decline in the real value of the minimum wage. At the very least, the fall in the wage floor has played a large part in the decline of the standard of living of many low-income workers.⁴

³ These estimates derived from using the approach found in Gordon (1996) and employment data from California’s Employment Development Department.

⁴ Statistical work performed for this report suggests that a \$1 decline in the real value of the minimum wage leads to a 61¢ decline in the real value of earnings of all workers over a period of 3 to 4 years.

Figure 1 shows the decline in the real value of the minimum wage. As can be seen, the decline in the real value of the minimum wage preceded the decline in the real value of earnings for all production workers. The decline of the minimum wage—that is, a decline in the wage floor—is a primary suspect for the widespread decline of wages for many workers in California.

Figure 1
Real Value of the Minimum Wage and Real Hourly Earnings



This decline of the minimum wage was an important cause of the rise of worker unfriendliness in California. The falling real value of the minimum wage is responsible for the growing ranks of the “working poor”: those who work but who are not able to escape poverty. The falling real minimum wage (in combination with workers being asked by employers to pay an increasing proportion of the cost of employer-provided benefits) make it impossible for many low-income workers to take advantage of employer-provided healthcare insurance or pension plans.

The Decline of Unions

The decline of unions also contributed to the post-1970s decline in worker friendliness. As unions declined, a lower proportion of workers benefited from higher union wages. Further, as unions declined fewer workers benefited from union-negotiated healthcare insurance, pension plans, and improvements in employment security, workplace health and safety, and workers' rights.

The decline of unions also hurt nonunion workers. When unions were strong, many nonunion businesses paid wages higher than they otherwise would have in order to reduce the attractiveness of unions to their workers. The threat of unionization also provoked many businesses to provide healthcare insurance, pensions, and to improve employment security, workplace health and safety, and workers' rights. With the decline of unions, however, nonunion workers no longer rode the coattails of union workers to better compensation and better working conditions.

Eroding Standards for Business Behavior

Third, and finally, an erosion of social standards for judging business behavior contributed to the decline in worker friendliness. Adam Smith, renowned author of *The Wealth of Nations*, argued that a market economy leads to good results for society *only if* a social and moral framework keeps businesses from the unfettered seeking of profit. As Smith argued, profit-seeking leads to socially beneficial results only if it is tempered by a strong sense that certain lines should not be crossed in the quest for profits: laws should not be broken, power should not be abused, and people should be treated decently.

The social and moral framework governing the United States economy has eroded significantly in recent years. From WWII to 1970, the expectation was that businesses would

share with their employees the benefits of economic success. Further, it was expected that profit seeking by a business had to be tempered—perhaps only a little, but still tempered—by the need to treat workers decently (Flanagan 1987; Bowles, Gordon, Weisskopf 1990; Gordon 1996).

By the 1970s, this social and moral framework started to weaken. Entrepreneurial initiative—unfettered by government, social, or, sometimes, moral regulation—became the new standard for many business leaders. The mass media, although expressing reservations about the erosion of business standards, helped legitimize this erosion by turning these new entrepreneurs into celebrities.

This erosion of the social and moral framework continued in the 1990s. During the 1980s, layoffs by a business that was already profitable were initiated by an *individual entrepreneur*—a corporate raider, say—in his quest for still greater profits and power. A backlash occurred against these individuals by the late 1980s. At the same time, this behavior was institutionalized—and depersonalized—by new claims that a business must, say, lay off workers although the business is making record profits because “the stock market requires” that the business does so in order to boost its earnings.

In the business world, the social and moral standards of society have now been replaced by the “needs” of the stock market. In the eyes of many, the stock market now “requires” that businesses do *not* share with their employees the benefits of economic success and do *not* temper their profit-seeking by the need to treat workers decently whenever possible.

In the words of Robert Reich, past Secretary of Labor, business has abandoned an “unwritten social contract”:

The most important part of the contract is that if the worker is diligent and reliable, and if the company is making money, that the worker keeps his or her job. The second principle is enjoying rising wages and benefits as a company's profits improve. This social contract is no longer with us.⁵

General Solutions

The above discussion leads directly to a set of general policy prescriptions to reverse the decline of worker friendliness. These policies are: boost the wage floor, reverse the decline of unions, and generate social pressure for better behavior by businesses.

Boost the Wage Floor

The most direct way to boost the wage floor is to increase the minimum wage. This will lead to higher incomes for as many as 3 million California workers and will permit many of those workers to purchase employer-provided healthcare and to participate in their employers' pension plan.

*The California State Assembly can demonstrate its commitment to improve the income of California working families by raising the California minimum wage. A worthy goal is to return the real minimum wage to the level it achieved in the late 1960s. This would require that the Assembly raise the California minimum wage to \$7.00 per hour in the year 2000.*⁶

⁵ Quoted in Gordon (1996), pp. 64-65.

⁶ An emerging consensus among many economists is that the harmful effect of an increased minimum wage on employment is small (e.g., Card and Krueger 1995).

An increase in the minimum wage, however, cannot be characterized as an “incentive.” For the purposes of this report, therefore, alternative—and less effective—policy options for improving worker friendliness will be considered.

Reverse the Decline of Unions

The decline of unions has contributed to the decline of wages and benefits over the past few decades. Any serious incentive-based policy to reverse the decline in worker friendliness must provide incentives for the expansion of unions.

Generate Social Pressure for Worker Friendly Behavior by Business

Although it would be hard to significantly reverse the erosion of the social and moral framework regulating the U.S. economy, small steps can be taken to improve matters. For instance, the Assembly can pass laws that implicitly, if not explicitly, indicate that they believe that a social and moral framework that accepts the importance of worker friendly workplaces should be reconstructed. These efforts would be more than just symbolic; they could contribute to a new social consensus about the responsibility that businesses have to their employees.

GENERAL FRAMEWORK FOR COST-BENEFIT ANALYSIS

I will subject each of the policies recommended in this report to a cost-benefit analysis. The goal of such an analysis is, first, to identify the possible effects of a recommended policy and, second, to determine whether the beneficial effects of this policy are “more important” than the negative effects of the policy.

Cost-benefit analyses tend to reduce everything to monetary terms or, more precisely, to ignore any effect that resists being reduced to monetary terms. For instance, while a \$10

million dollar increase in taxes is trivially easy to express in monetary terms, a belief that some policy is “the right thing to do” cannot be easily translated into monetary terms. The latter sort of factors tend to be ignored in cost-benefit analysis. Cost-benefit analysis is, therefore, an imperfect if not misleading art. Any conclusions it reaches about the net benefits or net costs of a policy must be supplemented by a democratically elected body’s subjective determination of factors that cannot be reduced to monetary terms.

Ideally, a cost-benefit analysis is generated from an investigation of similar policies implemented elsewhere. Unfortunately, the only programs existing in other states similar to those I recommend in this report appear to be those that provide tax credits to small employers or to employees for the costs of healthcare insurance. I could find no other incentive policies for promoting worker friendly businesses in other states.⁷ As a consequence, I must generally rely on indirect empirical evidence and relevant economic theory to generate the cost-benefit analyses presented below.

Procedures Followed

These cost-benefit analyses will be generated as follows. First, I will determine the impact of each recommended policy on the General Fund of the State of California. The costs

⁷ I contacted 25 state AFL-CIO labor councils to ask if they knew of any incentive policies within their state that promoted worker friendliness. State AFL-CIO labor councils should be knowledgeable about such programs. Some labor councils reported that their state had tax incentive programs for promoting healthcare insurance in small businesses while a few others reported that their state had an incentive program designed to attract *out-of-state* businesses that paid high wages or provided worker training.

to the General Fund might include the value of the tax credit provided, the costs of running a new state program, or other administrative costs. The benefits to the General Fund might include reduced outlays for Medi-Cal, recaptured tax credits, or increased tax revenue.

The net benefit to the General Fund is the benefits minus the costs. If the net benefit of a policy is zero, the recommended policy will have no impact on the General Fund balance. If the net benefit to the state of a policy is positive (that is, the benefits exceed the costs), the policy will increase the General Fund balance. A negative net benefit (costs exceed benefits) indicates that the policy reduces the General Fund balance.

Second, I will determine the costs and benefits to actors in the private sector of the economy. The costs of these policies fall mostly on private businesses. In fact, I will generally report as the cost of a policy the *net cost* to businesses of this policy. That is, any benefit businesses derive from a policy will be subtracted from the estimated costs to businesses to arrive at the net cost. For instance, if businesses experience increased costs of \$10 million because of the policy (because, say, they pay higher wages) but businesses also receive a tax credit equal to \$4 million (which is a benefit), I will report that the cost of this policy is \$6 million. In these analyses, the cost to the private sector generally equals the *net cost to businesses*.

What I present as the benefits to actors in the private sector of the economy will be the *net benefits going to workers* in California. If a policy leads to a \$10 million increase in income for workers, then the benefits of the policy will be \$10 million.

By keeping the impact on businesses (under the heading of “costs to the private sector”) separate from the impact on workers (under the heading of “benefits to the private

sector”), I will permit the reader to quickly see the income redistribution consequences of each recommended policy.

Third, I will present estimates for the total costs and total benefits of each recommended policy. The total costs will be the costs to the General Fund plus the costs to the private sector (more precisely, the net cost to businesses within California). The total benefits will be the benefits to the General Fund plus the benefits to the private sector (more precisely, the net benefit to workers in California). The total net benefit (total benefits minus total costs) of a policy indicates its impact on California as a whole.

Fourth, I will consider the costs and benefits (to the state and to the private sector) for a 5-year period. The impacts of most policies are spread out over many years and a full accounting of a policy’s costs and benefits requires taking into account the costs and benefits in both the present and the future. But because of the uncertainty of the impact of any given policy in the present and the greater uncertainty of the impact in the future and because of the uncertainty of future economic conditions, I will ignore any impacts beyond 5 years.

Because a dollar today is worth more than a dollar next year, I will “discount” all costs and benefits in years 2 to 5. I will discount future costs and benefits by 6% per year, which is the approximate interest rate on 5-year Treasury bond with a zero coupon. This is standard procedure in cost-benefit analyses.

By using a 6% discount rate, I assume that a dollar next year is worth only 964 today. That is, the “present value” of \$1 next year is 964 today. A dollar in two years, on the other hand, is worth only 894 today.⁸

⁸ These present values are determined by: $\$1/1.06 = \0.96 and $\$1/(1.06 \times 1.06) = \0.89 .

Finally, I will only present my “best estimate” for the costs and benefits considered. Any cost-benefit analysis is sensitive to the assumptions made in generating the required dollar values. A sensitivity analysis is the simplest and most frequently used method for showing how costs and benefits change as basic assumptions change (say, 20 percent of businesses respond to an incentive versus 30 percent of businesses respond). Yet because of the complexities of—and uncertainties about—the responses of private actors to the particular policies proposed, it is difficult to determine optimistic or pessimistic values of the key assumptions made. I will, therefore, just present my best estimate for costs and benefits. The reader, however, should necessarily take these estimates with a grain of salt.

The Costs and Benefits of Responding to Incentives

Many of the policies proposed in this report seek to change the voluntary choices businesses make by providing them an incentive to act differently. When incentives are used to change voluntary choices, cost-benefit analysis is simplified greatly.

When a business, say, decides to *voluntarily* provide a pension to its workers, the benefits to the business of providing this pension plan must have exceeded the costs to the business of the pension plan. This is the essence of voluntary choice.⁹

⁹ This does not imply that voluntary actions require that *monetary* benefits exceed *monetary* benefits. For instance, if you give \$10 to a needy person the monetary cost to you is \$10 while the monetary benefits to you is zero. But by giving this money away you have indicated that the *nonmonetary* benefits (“it is right to help those in need”) must have been (implicitly) worth more than \$10 to you (although this was not an actual monetary benefit).

A hypothetical example will help clarify the key issues. Suppose a pension plan will cost a business \$400,000 per year. Suppose, also, that when the business provides a pension plan its workers are grateful and grateful workers work harder and accept a slightly lower wage increase in the future because their employer is contributing to their pension plan. Further, the pension plan might permit the employer to attract better workers and keep good workers longer than otherwise would have been the case. Suppose the value of all these benefits to the employer is equal to \$500,000 per year. For this employer, the cost of the pension plan is \$400,000 while the benefit is \$500,000. The employer will choose to provide the pension plan.

Consider a second employer that has an identical situation to the above except that the benefit of the pension plan is only \$300,000 per year. For this second employer the cost (\$400,000) exceeds the benefit (\$300,000) and the employer will *not* voluntarily offer the pension plan.

Suppose, now, that a tax credit of \$150,000 is available to businesses that provide a pension plan. The second employer will now decide to voluntarily offer a pension plan. The new benefit for offering the pension plan is \$450,000 (that is, \$300,000 plus the \$150,000 tax credit). The new benefit exceeds the cost.

No matter what the cost and no matter what the tax credit, when an employer voluntarily responds to the tax credit incentive we know that the benefits (which includes the tax credit) equal or exceed the costs. *All* actors responding to incentives are better off than they were before.

But *how much* better off will they be? If the cost of some action before the credit is \$100 and the benefit before the credit is \$99, the action will not occur because the cost

exceeds the benefit. A tax credit of \$50 will increase the benefits above the costs by \$49 dollars; the desired action will now occur. But, if the cost before the credit is \$100 and the benefit is \$51, then a \$50 tax credit will boost the benefit above the cost by only \$1. The average *net benefit* for these two businesses (in the two extreme cases) is \$25. A reasonable assumption is that the average *net benefit* accruing to an actor responding to an incentive is one-half the value of the incentive provided.

This simplifies a cost-benefit analysis involving incentives. No matter what the actual costs and benefits before an incentive, we know that a business (or worker) that responds to an incentive is better off, on average, by at least one-half the value of the incentive provided. This reduces tremendously the amount the information needed to analyze many of the policies considered below.

INCENTIVES FOR IMPROVING COMPENSATION: EARNINGS

Earnings for California workers can be increased by boosting the wage floor, promoting the expansion of unions, and creating social pressure for businesses to treat their employees in a worker friendly fashion. Incentives, and other policies, can be used to achieve these things.

Boosting the wage floor will lead to an increase in earnings for many low-income workers. In addition, it will permit many workers to purchase healthcare insurance when they are offered it by their employer and to participate in employer-provided pension plans. Social pressure on businesses to act in a more worker friendly fashion will also benefit workers. Assembly actions to promote worker friendly behavior will also tend to create this social pressure.

Increased unionization will lead to increased earnings. But it will also improve worker friendliness in many other ways. Unions are associated with greater pension and healthcare insurance coverage, greater employment security, with improved health and safety conditions, and worker friendly employee relations. Because of the widespread effects of increased unionization, I will discuss voluntary incentives for promoting unionization in a section below, “Promoting Worker Friendliness By Promoting Unionization.”

Living Wage Policies

An increase in the minimum wage is the best way to boost the wage floor. However, increasing the minimum wage is not an incentive policy.

One alternative policy is to make use of local living wage ordinances in order to (slightly) boost the wage floor. For the most part, living wage laws provide for an increase in the minimum wage and benefits for employees of businesses that do business with the city.¹⁰

Living wage laws directly affect only a small number of employees. The Los Angeles living wage law provided wage increases to 5,000 employees. But more typical was the Oakland law that affected approximately 400 employees. A living wage law, however, creates upward pressure on the wages paid to other workers in the local area.

¹⁰ For instance, starting in 1997 Los Angeles required that businesses holding service contracts, holding concessions, or receiving subsidies from the city pay employees at least \$7.51 per hour and provide health benefits along with 12 paid days off each year. Oakland, San Jose, L.A. County, Pasadena, Hayward, and West Hollywood have also established living wage laws. Santa Monica and San Francisco are currently considering living wage ordinances.

An incentive could be provided to businesses in cities that establish living wage laws. This would increase support for living wage laws, particularly among businesses that already pay wages above the proposed living wage. Such an incentive program, however, would be very costly to the State.

For instance, suppose a mid-sized city such as Fresno established a living wage law. If a tax credit of \$500 was provided to the approximately 5,000 Fresno businesses with more than 5 employees, this would total \$2.5 million dollars in tax credits. As only about 600 employees would be affected by the living wage law, this works out to \$4,166 per employee helped by the living wage law. This per worker cost is greater than any increase an individual worker would get from the living wage policy. It would be better, then, just to give this money to the workers affected instead of providing an incentive to businesses to support the living wage policy.

An alternative incentive program would reward *local governments* (rather than businesses) that pass new living wage laws. One direct effect of this incentive program would be to increase the number of businesses subjected to living wage ordinances; an indirect effect would be to promote a social expectation that businesses compensate their employees fairly.

Policy Recommendation 1: Grant for Establishing Living Wage Law

The State would establish an incentive for the creation of living wage laws in local communities. Local governments could apply for a state grant to cover the cost of:

- studying the feasibility of a living wage law in their community,
- implementing the living wage law, and

- overseeing local businesses to determine if they are following the law (for the first year the law is in effect).

The value of the grant would be determined after the local community submitted a grant application that detailed the costs to them of establishing a living wage law. The value of each grant would vary.

This policy would raise the wage floor for a small number of workers. It also permits local communities to put social pressure on businesses in their area to act in a more worker friendly fashion. By implementing this policy, the Assembly would indicate that it believes that businesses should also be more worker friendly and would contribute to the expectation that businesses should act in this way.

Cost-Benefit Analysis 1

I will walk through this first cost-benefit analysis more carefully than those that follow. Once the layout of the associated tables is understood, later discussions of costs and benefits will proceed more rapidly.

State

The cost to the state of the grants distributed under this policy should be less than \$200,000 per community establishing a living wage ordinance.¹¹ If three communities established living wage laws in the first year of the policy and two communities in following

¹¹ For instance, Santa Monica is spending about \$75,000 for a study of its living wage proposal. The planning and enforcement cost of a living wage law for a local community should be less than \$100,000, which is equal to two worker years on these activities.

years, the state costs would be \$600,000 in the first year and \$400,000 in each of the following four years. (As discussed above, I only consider costs and benefits for a five-year period.)

Table 1 indicates these costs to the state. The present value of the \$600,000 cost in the first year is, of course, \$600,000. This appears as state costs under “First year” in the table.

Table 1
Policy Recommendation 1
Grant to Local Governments for Living Wage Law

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$1,200,000	\$600,000	\$600,000
Private	\$3,600,000	\$3,600,000	\$0
TOTAL	\$4,800,000	\$4,200,000	\$600,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$10,900,000	\$1,400,000	\$9,500,000
Private	\$32,700,000	\$32,700,000	\$0
TOTAL	\$43,600,000	\$34,100,000	\$9,500,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$12,100,000	\$2,000,000	\$10,100,000
Private	\$36,300,000	\$36,300,000	\$0
TOTAL	\$48,400,000	\$38,300,000	\$10,100,000

The present value (using a 6 percent discount rate) for the cost of \$400,000 in state grants in each of years 2 to 5 is \$1,400,000.¹² This appears under the heading “Years 2 to 5: Present Discounted Values” in the table.

¹² This is equal to: 377,000 + 356,000 + 336,000 + 317,000. These latter four numbers are, in turn, equal to 400,000/x, 400,000/x², 400,000/x³, and 400,000/x⁴, where x = 1.06.

The present value of state costs over the complete 5-year period is \$2,000,000, which is equal to \$600,000 plus \$1,400,000. This present dollar amount appears under the heading “Complete 5-Year Period: Present Discounted Value” in the table.

State spending on programs that help low-income families would fall with an expansion of living wage laws. If 1,500 total workers (directly and indirectly) gain increased compensation in the first year because of the establishment of three new living wage laws, if 1/3 of these workers previously were eligible for state aid for low-income families (assumed to be equal to \$200 per month), and all these workers previously eligible for state aid no longer needed this aid after the compensation increase, then the total reduction in state spending on programs to aid low-income families would equal \$1,200,000 annually for the initial wave of living wage laws. (Or, $1,500 \text{ workers} \times \frac{1}{3} \times \$200 \text{ per worker per month} \times 12 \text{ months}$.) This total is found under “First Year” in Table 1.

This reduced spending for workers benefiting from living wage laws in the first year of the policy would continue in later years. But other workers will also benefit from the formation of living wage areas in years 2 to 5. If 1,000 workers (in two new living wage areas) benefited annually from living wage laws established in these years, then the annual current benefit to the state would be \$800,000 for each year.

Of course, workers benefiting from living wage policies in year 2 would also benefit from these policies in years 3, 4, and 5 and the state will experience a reduction in spending in each of these years also. Similarly, living wage policies established in years 3, 4, and 5 would also lead to a decline in state spending on aid programs.

The total value of all these reductions in state spending in years 2 to 5 for all workers who no longer need state aid is \$10,900,000 in present value dollars. This total is found

under the heading “Years 2 to 5: Present Discounted Values.” The total benefit for the state for the full 5 years considered is, then, \$12,100,000 in present value dollars (found in the bottom rows of the table).

The net benefit to the state General Fund is simply the benefit to the state minus the cost to the state. In the first year, the recommended policy boosts the state General Fund by \$600,000: the cost of the grants is less than the reduction in state spending caused by reduced outlays on state programs for low-income families. Over the complete 5-year period, the present discounted value of the net benefit to the state is \$10,100,000.

Private Sector

I am assuming that living wage laws will affect a total of 1,500 workers in the first year. If each of these workers receives a \$2 per hour increase in compensation and works an average of 1,200 hours per year, total annual increase in compensation for these workers equals \$3,600,000.

This increased compensation for workers leads to increased costs for businesses. Increased costs for business, in turn, lead to some combination of reduced business profits and increased prices for the goods and services these businesses provide. But if these businesses face enough competition from other businesses not affected by the living wage policy, the increased cost to businesses will only reduce their profits. This policy should have no significant effect on their prices.

Business profits should be reduced by an amount equal to the increase in costs businesses experience: \$3,600,000. (Although better-paid workers are typically more productive workers, I will ignore this effect on business costs.)

In Table 1, the \$3,600,000 benefit to workers in the first year and the \$3,600,000 cost to business in the first year appear under the heading “First Year.” These two dollar amounts cancel out and the net benefit to the private sector in the first year is zero.

This \$3,600,000 benefit and cost to workers and businesses continue in later years. In addition, a total of 1,000 new workers will benefit from living wage laws in each of years 2 to 5. Each of these 1,000 worker cohorts receives higher wages equal to \$2,400,000 each year from the establishment of their living wage area until year 5. These higher wages are matched in each year by an increase cost of businesses of \$2,400,000.

The total present discounted value of the streams of increased benefits to workers and increased costs to businesses over the years 2 to 5 is \$32,700,000. As the benefit to workers equals the cost to businesses in each of these 4 years, the net benefit to workers in years 2 to 5 is zero. All these present discounted values appear in under “Years 2 to 5: Discounted Present Values.”

The total benefit to workers over the full 5-year period is \$36,300,000 in present value dollars. The total cost to businesses over the same period of time is also \$36,300,000. These totals appear toward the bottom of Table 1. The net benefit of this living wage policy to the private sector is zero.

However, more businesses are worker friendly than before. The living wage policy leads to greater worker friendliness by redistributing income away from businesses and to working families.

Net Benefit

The net benefit of this policy to all of California over 5 years is \$10,100,000 in present value dollars. The costs and benefits in the private sector cancel out while the

reduced outlays from the General Fund are greater than the value of the grants distributed by the state. Approximately 5,500 California workers will benefit from more worker friendly workplaces because of this policy.

INCENTIVES FOR IMPROVING COMPENSATION: HEALTHCARE INSURANCE

Between 1979 and 1997, the proportion of workers in private businesses with employer-provided health insurance fell from 72 percent to 65 percent (Farber and Levy 1998). Although this decline has slowed by the mid-1990s, it has not been reversed.

One helpful way to investigate this decline is to determine how changes in each of the following contributed to the decline:

- the offer rate (the proportion of workers who are employed in businesses that offer healthcare insurance to at least some of their workers),
- the eligibility rate (the proportion of workers who are eligible for the healthcare insurance offered by their employer), and
- the takeup rate (the proportion of workers who enroll in employer-provided healthcare insurance programs when they are eligible for them).

The offer rate has not declined in recent years. It has actually increased slightly: between 1988 and 1997 the offer rate rose from 82.7 percent to 83.5 percent.¹³ A higher proportion of businesses offer healthcare insurance (to at least some of their employees) than before.

¹³ Estimates for offer, eligibility, and takeup rates appearing in this section come from Farber and Levy (1998).

The recent decline in healthcare coverage was caused by a fall in both the eligibility rate and the takeup rate. Different types of workers, however, have been affected.

The eligibility rate declined significantly for short-term and part-time employees. Such “peripheral” workers had their eligibility rate drop from 80 percent to 70 percent over the last decade. This compares to the more-or-less constant 98 percent eligibility rate for “core” (long-term, full-time workers). Businesses have become less generous to their peripheral workers than they once were.

At the same time businesses have restricted access to healthcare insurance by their peripheral workers, they have expanded their use of such workers. Businesses increasingly use short-term employees, part-time employees, and consultants and these workers are increasingly denied access to employer-provided healthcare insurance.

The takeup rate has declined for “core” workers (long-term, full-time employees). In 1988, a core worker offered health benefits accepted them 93 percent of the time. By 1997, the takeup rate for core workers had declined to 88 percent. The causes of this decline in the takeup rate are clear. First, wages have fallen in real terms in recent decades: workers have less money available to purchase healthcare insurance. Second, employers have increased the contribution employees must make in order to enroll in employer-provided healthcare insurance. In 1980, for instance, 74 percent of full-time employees in medium and large private establishments had their healthcare insurance fully paid by the employers. By 1993,

this figure had fallen to 37 percent (Fronstin, Goldberg, and Robins 1997; Farber and Levy 1998). Many workers now just cannot afford their share of the cost of healthcare.¹⁴

Four additional facts are relevant to policies seeking to expand healthcare insurance coverage. First, although the offer rate for small businesses is greater than it once was, the offer rate is still low (Ginsburg, Gabel, et al. 1988). For instance, while the offer rate for businesses with more than 200 employees is 99 percent, the offer rate for businesses with 3 to 49 employees is only 64 percent (Buckmueller and Jansen 1997).

Second, research has established that the traditional policy responses to low healthcare insurance coverage (such as employer tax credits, employee tax credits, promoting risk pooling, and purchasing coalitions) have expanded healthcare insurance coverage only slightly (e.g., Buchmueller and Jansen 1997 and Sloan and Conover 1998). Significant growth in employer-provided healthcare coverage will be unlikely to follow from yet another use of the traditional policies.

Third, the lack of information by small businesses about new healthcare insurance options is one cause for the small response of healthcare insurance coverage to recent attempts to expand employer-provided healthcare insurance coverage. For instance, in California only 18 percent of very small employers (with 3-9 employees) knew about the Health Insurance Plan of California (HIPC) in the first couple of years the program was in effect. The HIPC program was designed to promote healthcare insurance coverage within

¹⁴ Some have claimed that recent expansions in Medicaid are responsible for declines in takeup rates. Most studies, however, find that the Medicaid expansions had only a small effect on takeup rates for private healthcare insurance.

small businesses but few small employers know of its existence. Introducing new programs will have little effect if the public is generally unaware of these programs.¹⁵

Fourth, research consistently shows that union status has a powerful effect on the probability of an employee having employer-provided healthcare insurance. For instance, Sloan and Conover (1998) shows that while tax credits given to businesses to offer healthcare insurances have no noticeable effect on healthcare insurance coverage, *the presence of a union increases the chance that a worker has healthcare insurance by 35 percent*. A switch to union status increases dramatically the probability that a worker is offered healthcare insurance.

A policy to increase healthcare coverage, therefore, might seek to achieve some or all of the following:

- 1) a reduction in the proportion of peripheral workers in the labor force,
- 2) an increase in eligibility rates for those who remain peripheral workers,
- 3) an increase in takeup rates for all workers,
- 4) an increase in offer rates for small businesses,
- 5) an increase in small businesses' knowledge about the HIPC program, and
- 6) an increase in unionization rates.

The policies I will propose in this report will not be designed to achieve all of the above. Instead, policies will be proposed to: increase the takeup rates of workers in small

¹⁵ Buchmueller and Jensen (1997). Most businesses learn about healthcare insurance options from brokers. HIPC, however, threatens to take business away from these brokers. Brokers, understandably, often neglect to inform existing or potential customers of HIPC.

businesses, increase the knowledge of small businesses about the HIPC program, and increase unionization rates through incentives. As before, because of the widespread effects of unions on worker friendliness I will leave the discussion of policies promoting unionization to a later section.

Policy Recommendation 2: Tax Credit for Purchase of Healthcare Insurance

The state should provide a tax credit to employees equal to the smallest of 75% of their premiums for employer-provided healthcare insurance or \$200. The tax credit would be available if:

- a) the employee did not have private health insurance the previous year,
- b) the employee works for an employer that has between 3 and 50 employees, and
- c) this insurance was purchased through a nonprofit purchasing coalition.

The state should make this tax credit available for only *a single year*.

If this tax credit is available for more than a single year, an overwhelming percentage of those who receive the tax credit would have purchased healthcare insurance even without the tax credit. In this case, the tax credit will no longer serve its intended purpose of (efficiently) promoting an increase in the takeup rate. This will be discussed below.

Cost-Benefit Analysis 2

I estimate that a 75 percent tax credit going to employees for their purchase of employer-provided healthcare insurance will increase the takeup rate for workers in small businesses from approximately 85% to 89.25%.¹⁶

Currently, the only nonprofit healthcare insurance purchasing coalition in California is that established under HIPC, which is currently available only to businesses with 50 or fewer workers. About 150,000 workers are now covered under healthcare insurance plans provided by HIPC. The proposed tax credit should increase the number of workers covered under the HIPC program by approximately 7,500 workers.¹⁷

But many more than this will receive the tax credit. Because of movements into and out of the labor force and because a number of businesses newly take part in the HIPC

¹⁶ Chernew, Frick, and McLaughlin (1997), using data from 1992 to 1993, estimated that with *no* tax credit the takeup rate for workers in small businesses was 89.0 percent. With a 75 percent tax credit, they estimated the takeup rate would rise to 92.6 percent. Other researchers have found, however, that unsubsidized takeup rates for workers is lower in recent years than that estimated by Chernew, Frick, and McLaughlin. Further, it is recognized that a greater proportion of workers are now turning down employer-provided healthcare insurance because the price is too high. Further, other researchers using different workers and different time periods have estimated greater responses to reductions in the price employees pay for their healthcare insurance coverage. I therefore use the estimated before and after takeup rates presented in the text.

¹⁷ $7,500 = ((89.25 - 85)/85) \times 150,000$.

program each year, a proportion of the labor force at any time will find they purchase healthcare insurance although they did not have coverage the previous year. And, most would have purchased healthcare insurance even without the tax credit. Despite this, they will be eligible for the tax credit because they meet the criteria above.

This turnover of employees in HIPC might be as high as 10 percent. If so, then 15,000 employees will be able to claim the tax credit—but as a windfall and not because they were responding to the incentive. Consequently, a total of 22,500 employees might receive the tax credit: 33 percent (or 7,500) who responded as desired by the tax credit and 66 percent (or 15,000) who experience a windfall.

If the tax credit was available the following year, then normal turnover might lead another 15,000 workers to be eligible for the tax credit although perhaps 85 percent of them would have purchased healthcare insurance even without the tax credit. Eventually only about 10 percent of those receiving the tax credit will have purchased healthcare insurance only because of the tax incentive. This tax incentive rapidly becomes an inefficient way of increasing the takeup rate within small businesses. Therefore, I recommend that the tax credit be available only a single year.

State

The average tax credit provided per worker would be approximately \$300.¹⁸ This tax credit would be provided to approximately 22,500 workers. The total cost to the state, then, will be \$6,800,000.

The growth in the number of California families covered by employer-provided healthcare insurance will reduce the number of people in the Medi-Cal program. One out of seven people in California is eligible for Medi-Cal sometime during the year. Strict needs tests restrict Medi-Cal coverage to low-income families and, so, the proportion of low-income workers eligible for Medi-Cal is far higher than one out of seven. These low-income families are exactly those who would be willing to buy employer-provided healthcare coverage only if a tax credit reduced their costs.

I will assume that $\frac{1}{4}$ of those responding to the tax credit (about 1,900) previously were participating in the Medi-Cal program. As each worker is likely within a household with other members, I will assume that the 1,900 workers on Medi-Cal have an equal number of dependents also on Medi-Cal. This leads to the conclusion that 3,800 people will leave Medi-Cal because of the tax credit.

According to state records, the average state spending per person in Medi-Cal is about \$1,500 per year. In this case, the savings in Medi-Cal spending caused by a reduction of 3,800 participants is \$5,700,000 during the single year the tax credit is made available.

¹⁸ According to a Franchise Tax Board analysis of a similar proposal, AB 1061 from the 1999/2000 session, the average individual spends about \$400 per year for this or her share of healthcare insurance premiums (Franchise Tax Board 1999a).

But, in the years following the tax credit some workers who responded to the tax credit will continue to buy employer-provided healthcare insurance even though the tax credit is no longer available. Having experienced private healthcare coverage, many employees might decide that the expense of employer-provided healthcare insurance is worth it. But many will decide otherwise. I will assume, therefore, that each year 50 percent of these workers drop their employer-provided healthcare insurance and, perhaps, go back into the Medi-Cal program. In year 2, then, only 950 workers (out of the initial 1,900) continue to buy healthcare insurance through their employer. The other 950 will drop employer-provided healthcare insurance and return to the Medi-Cal program. The following year, only 475 will keep their employer-provided healthcare insurance. By year 5 only 119 workers will keep their employer-provided healthcare insurance.

This implies that in the first year 3,800 (2 family members per employee x 1900 employees) people are off the Medi-Cal rolls, in the second year 1,900 are off the Medi-Cal rolls, and in the third year 950 are off the rolls, and so on. State savings from reductions in Medi-Cal spending continues in later years but diminishes in each year: \$5.7 million in savings the first year, \$2.9 million in the second year, \$1.4 million in the third year, and so on.¹⁹

Table 2 presents the costs and benefits to the state General Fund. In the first year the cost to the state is \$6,800,000 while in later years the costs are zero: the tax credit is available

¹⁹ After the fifth year, it might make sense to make the tax credit available once again for a single year in order to set into motion another (temporary) increase in tax incentive-induced increases in employer-provided healthcare insurance.

only a single year. In the first year, the exit of people from the Medi-Cal program leads to reduced state outlays of \$5,700,000. The present value of the reduced outlays for Medi-Cal for years 2 to 5 is \$4,800,000. The reduced outlays for Medi-Cal falls off rapidly due to the assumed 50 percent drop rate of those who initially responded to the incentive.

Table 2
Policy Recommendation 2
75% Tax Credit for Healthcare Insurance

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$5,700,000	\$6,800,000	- \$1,100,000
Private	\$5,600,000	\$0	\$5,600,000
TOTAL	\$11,300,000	\$6,800,000	\$4,500,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$4,800,000	\$0	\$4,800,000
Private	\$0	\$0	\$0
TOTAL	\$4,800,000	\$0	\$4,800,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$10,500,000	\$6,800,000	\$3,700,000
Private	\$5,600,000	\$0	\$5,600,000
TOTAL	\$16,100,000	\$6,800,000	\$9,300,000

The net cost to the state General Fund is \$1,100,000 in the first year. This becomes a net benefit to the state in years 2 to 5. This net benefit for this 4-year period is \$4,800,000 in present value dollars. Over the full 5-year period considered, this policy increases the General Fund balance by \$3,700,000 in present value terms.

Public Sector

If more employees accept employer-provided healthcare insurance, businesses will spend more for healthcare. However, this healthcare insurance is provided voluntarily by the business. It stands to reason, then, that the benefit from offering this healthcare insurance to

these new workers must exceed the cost. But, for the sake of simplicity, I will assume the net benefit going to employers for providing healthcare insurance is zero for each of the 5 years considered in this report.²⁰

Employees benefit from this policy. They receive the tax credit (\$300 on average) which subsidizes their purchase of healthcare insurance. As discussed above in the general discussion of cost-benefit analysis, the average net benefit per worker receiving the tax credit is half the value of the tax credit. If 7,500 workers respond to the tax credit, then the net benefit for these workers will be \$1,125,000 (or \$150 per worker x 7500 workers).

On the other hand, 15,000 workers will receive the tax credit even though they would have purchased employer-provided healthcare even without the tax credit. For each of these workers, the net benefit from the tax credit is \$300. This money, in essence, does not go to subsidize healthcare insurance but permits the worker to purchase something else worth \$300 to them. The benefit to these latter workers is \$4,500,000.

The total benefit of this policy (to workers) is, therefore, approximately \$5,600,000 in year 1. In later years, however, the tax credit is not available. And, so, the benefit going to all workers is zero in years 2 to 5.

²⁰ Increased healthcare spending by business will increase the amount businesses can claim as a deduction on federal and state income tax forms. But if the monetary benefits of healthcare insurance equal the monetary costs, then the increased income businesses gain from providing healthcare benefits will, more or less, cancel out the effect of increased deductions. Tax payments by businesses and tax revenues for the state will remain unchanged.

Net Benefit

As seen in Table 2, the net benefit of this policy to California is \$9,300,000 (in present value terms). The largest portion of this benefit comes from the benefit that working families receive.

Unlike in Policy Recommendation 1, the benefit going to workers (\$5,600,000) does not come at the expense of businesses. No income redistribution was involved. The net benefit to working families of this tax credit to employees when they purchase employer-provided healthcare insurance, however, is far lower than that produced by Policy Recommendation 1.

Finally, I estimate that as many as 7,500 workers will be able to afford healthcare insurance who were not able to purchase it before. This is a small, but important, increase in employer-provided healthcare insurance coverage because it helps among the most needy of California's working families.

Policy Recommendation 3: HIPC Outreach Program

The Assembly should pass legislation promoting the dissemination of information about the HIPC program. The program should target small employers and should be for a single year. This outreach program can be modeled on the Savings Are Vital to Everyone's Retirement Act of 1997 (H.R. 1377), which focuses on disseminating information about pension plans to employees.

Cost-Benefit Analysis 3

In the mid-1990s, only 24 percent of businesses eligible for HIPC knew of the existence of the program. Approximately 1.2 million workers are employed in these

businesses.²¹ Of these workers, about 12.5 percent (or 150,000 workers) get employer-provided healthcare insurance through the HIPC program.

If the proposed information campaign increased awareness of the HIPC program by 2.4 percentage points (so that 26.4 percent of businesses were aware of HIPC), then employers of 120,000 more workers would know of HIPC. If the 12.5 percent coverage ratio was appropriate for these workers, then 15,000 more workers would get employer-provided healthcare insurance through HIPC.

However, some of these workers already would have had employer-provided healthcare insurance. Their employer was merely shifting to a lower-cost provider. I will assume that only 1/3 of these workers newly receive employer-provided healthcare insurance.

State

A campaign designed to increase awareness of the HIPC program among small businesses would be relatively inexpensive. For instance, the Savings Are Vital to Everyone's Retirement Act of 1997 budgeted \$1,000,000 for a *national* outreach effort to expand public knowledge pension plans. A *state* outreach program (which could be more ambitious than the national program) would likely cost no more than \$500,000.

If 5 percent of the estimated 5,000 new workers enjoying employer-provided healthcare insurance for the first time left Medi-Cal and if each worker leaving Medi-Cal was part of a two-person family, then 500 people would leave Medi-Cal rolls. If the state had

²¹ This estimate was derived from Buchmueller and Jensen (1997, table 2) and employment data from the Employment Development Department.

spent \$1,500 on each of these people for Medi-Cal, then the state would reduce Medi-Cal spending by \$750,000. This spending reduction should also occur in following years. As seen in Table 3, the present value of this spending reduction in years 2 to 5 is \$2,600,000.

Table 3
Policy Recommendation 3
HIPC Outreach Program

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$750,000	\$500,000	\$250,000
Private	\$1,000,000	\$0	\$1,000,000
TOTAL	\$1,750,000	\$500,000	\$1,250,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$2,600,000	\$0	\$2,600,000
Private	\$3,500,000	\$0	\$3,500,000
TOTAL	\$6,100,000	\$0	\$6,100,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$3,350,000	\$500,000	\$2,850,000
Private	\$4,500,000	\$0	\$4,500,000
TOTAL	\$7,850,000	\$500,000	\$7,350,000

Private Sector

More workers will benefit from healthcare insurance and some employers will be able to purchase healthcare insurance at a lower cost. If this improvement can be valued at \$200 per worker, then the total benefit for the private sector is \$1,000,000 for each year. Unlike in the other cost-benefit analyses in this report, the impact on businesses is included in the benefit column.

As seen in the table, the present value of this benefit in year 1 is, of course, \$1,000,000 while the present value of the benefits for years 2 to 5 is \$3,500,000.

Net Benefit

The state General Fund balance is increased by this policy. In the first year, the balance should improve by about \$250,000. The improvement in the General Fund balance over the full 5 years considered (in present value terms) is \$2,850,000.

The private sector benefits from this policy by \$1,000,000 in the first year and \$4,500,000 in present value over 5 years. Workers and businesses share this benefit.

IMPROVING COMPENSATION: PENSION PLANS

Between 1979 and 1999, the number of workers *without* pension coverage grew from about 45 million to 69 million.²² In addition, the quality of pensions for those lucky enough to have one have declined significantly. Businesses are increasingly offering defined contribution pension plans (e.g., 401(k) plans) rather than defined benefit plans. The former type of pension plans shift much of the investment risk of pensions away from businesses and toward workers. At the same time, many employers are cutting back their contribution to pension plans. For example, the American Academy of Actuaries reports that seventy percent of the time that a corporation replaces its defined benefit plans with individual defined contribution plans, the corporation offers less generous benefits to its employees.

Within California, the number of California corporations offering pension plans did increase between 1995 and 1996. But the total dollar value of the deductions taken by these corporations for pension and profit-sharing plans fell by 21 percent over this same one-year

²² Derived using Bloom and Freeman's (1992) figures for the percentage decline in pension coverage between 1979 and 1992. I assumed that between 1992 and 1999 pension coverage remained constant.

period (California Franchise Tax Board 1999b). California businesses have significantly cut back their contribution to their employees' pension plans.

For good reason, most attempts to improve pension coverage and pension quality focus on small businesses. Only 29 percent of employers with 100 or fewer employees offer pension plans. This falls far short of the 83 percent of employers with more than 100 employees that offer pension plans. Small businesses almost invariably offer defined contribution pension plans with relatively small employer contributions.

Why do so few small businesses offer pension plans, high quality or otherwise? Surveys show that small businesses believe that the cost of setting up and administering a pension plan, in particular defined benefit plans, is too high. They also believe that most pensions are too complex for non-experts to administer.

The federal government is addressing these concerns. In 1996, the Congress created a low-cost and simple defined contribution pension plan for small businesses called the Savings Incentive Match Plans for Employees of Small Employers (SIMPLE). Recently, the Clinton Administration proposed the creation of a low-cost and simple defined benefit plan for small businesses named Secure Money Annuity or Retirement Trust (SMART).

A low-cost and simple defined benefit pension plan might soon be available to small employers *if adequate pressure is placed on Congress*. California working families would be best served by vocal Assembly support for proposed federal legislation to create low-cost and simple defined benefit pension plans. Any incentive plan established by California to promote pension plans would have a minor impact on pension coverage compared to that of current federal pension initiatives.

In addition, the Clinton Administration has recently proposed a shortening of the permitted vesting period for all pension plans. A shorter vesting period would help all workers. California working families would be well served by vocal Assembly support for this latter proposed change in federal pension law.

But even if low-cost, simple, and quality pensions do become available to small businesses, no guarantee exists that employees in small businesses will benefit from them. Three factors hinder the increase of pension coverage for employees.

First, small businesses are often woefully informed about pensions. For instance, most small business owners know nothing about the already-existing SIMPLE and SEP plans. This lack of knowledge about pensions will be unlikely to change even if the federal government expands further pension options for small businesses (Employee Benefit Research Institute 1998). A partial remedy for this lack of knowledge on the part of business owners is a State campaign to inform them—and employees—about the many options available to small businesses and about the true costs and level of complexity of the various options.

Second, only 21 percent of workers in small businesses participate in a pension plan when offered one by their employer. The primary cause of the low “take-up” rate for pensions in small businesses is the low (and declining) income of many workers. Low-income workers decline to participate in pension plans requiring contributions by employees because these workers need the money to maintain their current (low) standard of living. Bloom and Freeman estimate that as much as 20 percent of the post-1979 decline in pension coverage was caused by falling real incomes. The obvious policy response is to promote a more rapid growth in wages for low-income workers.

Third, as much as 25 percent of the decline in pension coverage has been caused by a fall in unionization. Unions have traditionally bargained for pension plans; the decline of unions was paralleled by, not surprisingly, a decline of the proportion of workers covered by pensions. An obvious step to increasing pension coverage is to promote the growth of unions (Bloom and Freeman 1992).

Yet, once again, I will delay my discussion of policies to promote unionization through the use of incentives later.

Policy Recommendation 4: Support for Federal Pension Initiatives/Outreach Program

The California State Assembly should strongly and vocally support attempts at the federal level to create low-cost and simple defined benefit pension plans. In addition, it should support the shortening in vesting periods proposed by the Clinton Administration.

The Assembly should also pass legislation promoting the dissemination of information about low-cost and simple pension plans options. The program should target both small employers and workers. This outreach program can be modeled on the Savings Are Vital to Everyone's Retirement Act of 1997 (H.R. 1377), which focuses on outreach to employees (but not to businesses). This bill was signed into law in November 1997.

Cost-Benefit Analysis 4

A conservative estimate of the impact of current federal pension initiatives, if they become law, is that pension coverage will expand by 1 percentage point (from about 45 percent to 46 percent). If pension coverage expanded by this amount in California, about 150,000 additional workers would receive pensions.

No guarantee exists, however, that these federal initiatives will become law. Assembly support, however, would increase the probability that they do become law. The impact of vocal Assembly support on this probability is unknowable. I will assume, therefore, that vocal assembly support increases the probability that federal pension initiatives become law by 5 percent. That is, if a 50 percent chance exists that these federal initiatives will become law without Assembly support, with assembly support this probability becomes 55 percent.

It would be reasonable to credit vocal Assembly support for federal pension initiatives for 7,500 more workers with pensions. This number represents 5 percent of 150,000. I will assume that employers contribute \$2,000 annually to each employee's pension plan. According to Franchise Tax Board data, this is somewhat less than California businesses typical contribute annually to pension plans.

The impact of a state campaign informing businesses and workers of existing low cost and simple pension plans on pension coverage is also unknowable. I will assume that as a result of this campaign an additional 7,500 workers will receive pensions in the year the campaign occurs.

I will assume, then, that the above policy would be responsible for an increase in 15,000 workers with employers who contributing to their pension. I will also assume this is a one-time increase experienced in the same year the policy is implemented. These contributions to workers' pensions will continue over the whole 5-year period considered here. However, not all workers who have pension contributions made in their name end up being vested. Workers that do not become vested lose these employer contributions. I will

assume that only 50 percent of the 15,000 workers newly covered by pension will end up becoming vested.

State

The direct cost to the state of the above policy is very low. Vocal support of federal initiatives is, of course, free. A campaign informing businesses of pension options would be relatively inexpensive. For instance, the Savings Are Vital to Everyone's Retirement Act of 1997 budgeted \$1,000,000 for a *national* outreach effort involving public service announcements, conferences, an Internet site, and more. A *state* outreach program (which could be more ambitious than the national program) would likely cost about \$500,000.²³

Private Sector

If 15,000 workers each gain new pensions worth \$2,000 per year, then the annual benefit to workers is \$30,000,000. But as only half these workers will end up becoming vested, the actual annual benefit to workers is \$15,000,000. If this amount is also contributed each year to pension plans (and received by vested workers) in years 2 to 5, then the present value of these contributions will be \$52,000,000.

As businesses will be providing these pensions voluntarily, the increased cost to business in providing these pensions should be matched by increased benefits going to the business. The net impact on business will be, once again, zero.

²³ As before, I will ignore the impact that increase spending on pensions has on state tax revenues. I also ignore future reductions in spending by state programs that help low-income elderly citizens. These benefits to the state are hard to quantify and, in any case, are experienced far beyond the 5-year period considered in this report.

Net Benefit

As seen in Table 4 this policy leads to a net benefit of \$66,500,000 in present value terms over the 5-year period considered. These benefits go entirely to workers in the private sector. The state experiences a small reduction in the General Fund balance.

Table 4
Policy Recommendation 4
Support of Federal Initiatives and Outreach Program

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$0	\$500,000	- \$500,000
Private	\$15,000,000	\$0	\$15,000,000
TOTAL	\$15,000,000	\$500,000	\$14,500,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$0	\$0	\$0
Private	\$52,000,000	\$0	\$52,000,000
TOTAL	\$52,000,000	\$0	\$52,000,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$0	\$500,000	- \$500,000
Private	\$67,000,000	\$0	\$67,000,000
TOTAL	\$67,000,000	\$500,000	\$66,500,000

INCENTIVES FOR IMPROVING EMPLOYMENT SECURITY

Employment security exists when workers who do their jobs well have little fear of losing their jobs. As noted above, employment security has declined in recent years.

Sometimes a business has no choice but to lay off a number of workers. A major loss in sales, perhaps due to a recession or a loss in competitiveness, can force a business to permanently or temporarily lay off workers.

At other times, though, a business decides to lay off a worker because the benefit (in lower labor costs) is just a bit larger to the business than the cost of such a layoff. One cost is the subsequent increase in the Unemployment Insurance (UI) tax the business must pay. UI tax rates are “experience weighted”: increased layoffs lead to a higher UI tax.

Table 5 presents a section from the California UI Tax Rate Schedule (Employment Development Department, 1998). The Reserve Ratio appearing in the table is the following: the business’ reserve account balance ÷ the business’ average base payroll. The table shows that if this ratio is between .16 and .17 (the bottom row), then the business pays a UI tax equal to 1.1 percent of its payroll to the UI fund.

Table 5
Unemployment Insurance Tax Rate Schedule, Partial

Reserve Ratio Exceeds or equals	Reserve Ratio Less than	Contribution Rate Schedule C
-.14	-.12	5.4
-.12	-.11	5.4
-.11	-.10	5.3
.15	.16	1.2
.16	.17	1.1

As a business lays off workers, the reserve ratio falls. If it falls to, say, between 0.15 and 0.16 (the second row from the bottom), the UI tax grows to 1.2 percent. If the business lays off enough workers, it loses all its reserves and the reserve ratio becomes negative. As seen, as its reserve ratio falls, say to between -.11 and -.10, a business pays a quite large UI tax. (The table skips many rows for the sake of conciseness).

But, as seen, as the reserve ratio moves from -.11 to -.12, further layoffs do not lead to an increased UI tax rate. The business has reached the “plateau” in the tax rate schedule. The maximum tax rate in Table 5 is 5.4 percent. Once its reserve ratio falls to this level, a business that continues to lay off still more workers is not punished by the imposition of a higher UI tax rate. In fact, layoffs by businesses within the plateau are subsidized by businesses with reserve ratios below the plateau.

The UI tax structure can be revised to increase the incentives for avoiding layoffs. In particular, if the UI tax grows faster as the reserve ratio falls and if the tax plateau is eliminated, the cost for layoffs will be increased. Fewer layoffs—and greater employment security—would result (Rejda and Rosenbaum 1990).

Table 6 presents a section of a *hypothetical* UI Tax Rate Schedule modified to increase the incentive to reduce layoffs. This modified UI Tax Rate Schedule: 1) reduces the UI tax rate for employers who lay off few workers (those in the lower two rows), 2) increases the UI tax for employers who lay off many workers, and 3) eliminates the plateau in the UI tax schedule (the UI tax rate continues to rise as a business’s reserve ratio continues to fall).

Table 6
Hypothetical UI Tax Rate Schedule that Promote Employment Security

Reserve Ratio Exceeds or equals	Reserve Ratio Less than	Contribution Rate Schedule C
-.14	-.12	6.8
-.12	-.11	6.6
-.11	-.10	6.4
.15	.16	0.9
.16	.17	0.8

Policy Recommendation 5: Restructure Unemployment Tax Rate Schedule

Restructure the existing California UI tax rate schedule so that businesses *with few layoffs* are rewarded with lower UI tax rates than they currently face. Further, restructure the UI tax rate schedule to eliminate the UI tax plateau, which acts as an implicit subsidy for businesses that layoff many workers.

Cost-Benefit Analysis 5

The above policy would lead to a fall in the number of workers who get laid off. Approximately 1,000,000 workers each year receive UI benefits sometime during a year. Far more workers, of course, are laid off as many laid off workers are not eligible for UI benefits or fail to apply for these benefits. I will assume the recommended policy leads to an annual reduction in layoffs equal to 10,000. This is equal to 1% of the total number of laid off workers eligible for UI benefits.

State

The costs to the state would include the cost of a study to determine how to change the California UI tax rate schedule to achieve increased employment security and revenue neutrality. This study would likely cost less than \$20,000.

The benefit to the state would be reduced spending on programs that benefit the poor. If the 10,000 people no longer laid off had each received \$200 in state aid, directly and indirectly, then this would be an annual reduction in spending on these programs of \$2,000,000. This figure appears in Table 7

Table 7
Policy Recommendation 5
Change Unemployment Insurance Tax Rate Schedule

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$2,000,000	\$10,000	\$1,990,000
Private	\$40,000,000	\$1,900,000	\$38,100,000
TOTAL	\$42,000,000	\$1,910,000	\$40,090,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$6,900,000	\$0	\$6,900,000
Private	\$138,600,000	\$6,600,000	\$132,000,000
TOTAL	\$145,500,000	\$6,600,000	\$138,900,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$8,900,000	\$10,000	\$8,890,000
Private	\$178,600,000	\$8,500,000	\$170,100,000
TOTAL	\$187,500,000	\$8,510,000	\$178,990,000

In addition, fewer layoffs will lead to smaller outlays for unemployment benefits. These outlays, however, do not come out of the General Fund but out of the UI insurance trust fund. The General Fund will experience no change due to reductions in unemployment benefit outlays.

Private Sector

Workers would benefit from lower layoffs. The average unemployed production worker, earning \$17,000 annually and being unemployed for 15 weeks, loses about \$5,000 in employment income when laid off. About half of laid off workers, however, are typically eligible for UI benefits, equal to about 40 percent of weekly employment income for each week unemployed after the first week of unemployment. If 10,000 workers had been laid off, then 5,000 of them would have lost \$5,000 each and 5,000 would have lost only, say, \$3,000 each because of UI benefits they receive. The total loss in income for these workers would have been \$40,000,000.

The policy proposed above would lead these workers to keep their jobs. The benefit of this policy to these workers is, then, \$40,000,000. I will ignore other possible benefits following from a decline in unemployment.

Workers would also benefit from lower layoffs in years 2 to 5. The present value of an annual benefit of \$40,000,000 in these years is \$138,600,000.

Employers, on the other hand, would have higher costs because of this policy. By not laying off 10,000 workers, employers' wage costs will rise. For instance, for a 15-week period the increased wage costs would equal \$50,000,000 (10,000 workers x \$5,000 wages per worker).

However, the increased employer costs due to the proposed change in the unemployment insurance system is far below this cost. Suppose that a worker earns \$5,000 during some period of time. Suppose, also, that the income the employer derives from employing this worker is only \$4,000 during the same period of time. If the UI tax the employer pays would increase by \$500 if this worker was laid off, it would make sense for the employer to lay the worker off. Keeping the worker leads to a loss of \$1,000 but laying the worker off leads to an increase in UI tax (i.e., a loss) equal to \$500. As a \$500 loss is better than a \$1,000 loss, the employer lays the worker off.

Suppose, now, that the UI tax increase was higher, say \$1,001 instead of \$500. Now the business will not lay the worker off. By keeping the worker employed, the business loses \$1,000. But by laying the worker off the business must pay \$1,001 in increased UI tax. A business will reasonably decide to keep employing the worker in this situation.

Importantly, the increased cost to the employer is the value of the *increase* in the UI tax payment: \$501 in this example. It is equal neither to the wage cost, \$5,000, nor to the full UI tax, \$1,001.

If 10,000 workers were laid off they would have earned about \$9,300,000 in UI benefits. Businesses throughout California would have eventually had to pay more into the UI fund to make up this decline of \$9,300,000 in the fund. But these layoffs did not occur because the businesses laying off these workers were forced to pay a higher proportion of this \$9,300,000 (and other businesses not laying off workers paid less into the UI fund). If these businesses had to pay the full cost of the decline in the UI fund instead of, say, only 80 percent of this, the increase in the UI tax to these businesses would have equaled \$1,900,000.

This latter figure would be the true cost to businesses of the change in the UI tax rate schedule caused by this policy. I will ignore other benefits to business such as reduced hiring costs, better productivity due to better morale, and greater worker skills due to longer tenure by workers that would reduce this cost to business.

The total cost to businesses of this policy recommendation would be fairly low. As seen in Table 7 the present value of the increased \$1,900,000 in each of years 2 to 5 is equal to \$6,600,000. The total cost (in present value) to businesses of this policy is \$8,500,000.

Net Benefit

The total benefit of this policy to the state and the private sector will be \$178,990,000 in present value terms over the 5-year period considered. Businesses will experience relatively small costs. The state General Fund will be improved by a small amount. Most of the benefit of this policy comes from workers keeping their jobs rather than being laid off.

PROMOTING HEALTHY AND SAFE WORKING CONDITIONS

Empirical measures suggest that enforcement of existing law has promoted the appearance of safer workplaces. As an example, California saw a 17 percent drop in the incidence of nonfatal occupational injury and illness in private industry over 1994-1997.

This does not mean, however, that there are no unsafe workplaces or that particular health and safety problems do not exist. Many workers are hurt or killed each year because of flagrant violations of health and safety laws by a few businesses. Repetitive motion injuries and back injuries are continuing to affect thousands of California workers each year. For instance, the Bureau of Labor Statistics reports that each year more than 50,000 California workers miss one or more days of work because of repetitive motion or overexertion injuries.

Most businesses already provide healthy and safe workplaces; a small number of violators cause the greatest harm. An incentive program aimed at all businesses would, therefore, be very costly with little additional improvement in health and safety. On the other hand, those businesses that routinely violate health and safety laws would be unlikely to respond to the incentives.

Ergonomic standards, designed to reduce adverse outcomes such as repetitive motion injuries, have yet to be fully implemented in California. Providing an incentive program to reward businesses that follow the new standards (mandated by law) would also be very costly because it is possible a vast majority of businesses do not meet reasonable ergonomic standards.

Incentive programs, therefore, would be a poor choice for addressing health and safety issues in the workplaces. Other policy options should be pursued.

And they are. A bill recent passed by the Assembly (and signed into law) does pursue these other policy options. AB 1127 increased civil and criminal penalties for willful, serious and repeat violations of occupational safety and health standards and restated the legislators' desire for the implementation and enforcement of ergonomic standards. Other bills in recent years have likewise promoted more safe and healthy workplaces within California.

Policy Recommendation 6: Continue Status Quo

Do not establish incentive programs aimed to promote more safe and healthy workplaces. Rather, the California State Assembly should continue to address the problem of unsafe and unhealthy working conditions by targeting willful violators of existing California and Federal health and safety laws. The Assembly should also continue to insist that ergonomic standards that minimize repetitive motion injuries be introduced and enforced statewide. Finally, the Assembly should also strongly and vocally criticize attempt to weaken health and safety laws at the federal level.

Cost-Benefit Analysis 6

Beyond recommending vocal criticisms of attempts to weaken federal health and safety laws, policy recommendation 6 is to continue on with current policy initiatives. The costs of this policy recommendation are zero. The benefits, however, might be significant if vocal Assembly criticism of attempts at the federal level to weaken health and safety laws play an important part in protecting these federal laws. The dollar value of this benefit, however, is hard to quantify. I will, therefore, not do so.

INCENTIVES FOR WORKER FRIENDLY EMPLOYEE RELATIONS

As noted above, most workers want to work for a business that has a set of rules—fair, formal, and enforceable—governing employee relations within the business. Further, most workers want a workplace organization that gives workers the ability to communicate their suggestions and complaints to management and, more importantly, to influence decisions that directly affect them.

Employees would gain these worker friendly employee relations in three ways:

- if management voluntarily provided such employee relations,
- if workers moved to another business that offered workers' the employee relations they desire, or
- if a union enters the workplace.

In this section I will consider the first two ways that workers can come to benefit from worker friendly employee relations. The third, unionization, will be discussed in the following section.

Worker friendly employee relations are not only desired by workers, they have an important side effect: they give a business a two percent to five percent boost in productivity relative to workplaces with traditional employee relations (Blinder 1990). Freeman and Rodgers (1999, 42-43) report one of the causes of this productivity boost, “Fifty-eight percent of managers agreed with workers that workplace problems would be more effectively solved at their company if employees collectively had more say.”

But if *both* workers and businesses benefit from worker friendly employee relations, why are such workplaces not found more frequently?

Some managers would like to switch to worker friendly/high performance employee relations, but the *short-run costs* of switching employment relations—along with a lack of knowledge about how to successfully construct such a workplace—keep them locked into a “second-best” system of employee relations (Levine 1992). Economists identify this situation as market failure caused by path dependence and imperfect information: given the (historically determined) costs and benefits they face and given the incomplete information they have, individual actors find it rational to act in ways that lead to inefficient outcomes (e.g., David 1993).

A policy that reduces the short-run costs of switching to worker friendly/high performance workplaces could eliminate this market failure. The business, their workers, and society would be better off as a result.

On the other hand, an individual worker in a business with poor employee relations could experience worker friendly employee relations by moving to a business that had such employee relations. Workers, however, rarely switch employers to improve the employee relations they experience in the workplace.

The reason is simple: workers know little about employee relations at other businesses. Businesses generally treat their employee relations policies as private information that is not divulged to outsiders. Indeed, even some businesses that have *written* employee relations policies make it difficult for their own employees—much less outsiders—to discover what these written policies say (Edwards 1993).

Because employees have only poor information about employee relations in other businesses, they are generally unable to choose an employer based, in part, upon the employer's employee relations.²⁴ Many would like to do so, however.

This is another market failure. This time it is caused by asymmetric information: businesses have the information that workers need to make good decisions, but businesses refuse to share this information with workers. A less-than-ideal outcome is the consequence.²⁵

A policy that promotes the *public* dissemination of information about businesses' employee relations policies could help eliminate this market failure. This policy would permit individual workers to seek out businesses that had the employee relations they desire.

Most important, greater public knowledge about the employee relations within businesses will actually *increase* the proportion of businesses that have worker friendly employee relations. As workers desire good employee relations, if information about employee relations was public then some businesses would be able to get better workers by improving their employee relations. If two businesses offered the same compensation, the

²⁴ Although workers gain some information by word-of-mouth, the quantity and quality of information about employee relations gained in this way are low.

²⁵ A labor market without good information about the employers' employee relations is similar to a (hypothetical) television market that only permits buyers to learn of the content of warranties—or if a warranty even exists—only after a buyer has already bought the TV and experienced troubles with it. Economic efficiency requires that economic actors be fully informed about the products—and the jobs—before they make their choices.

one that offered better employee relations would be able to get the better workers. With the public dissemination of employers' employee relations, businesses would be forced to compete with other businesses in labor markets on both how high their wages are and on the extent of worker friendly employee relations within businesses. That is, the public dissemination of businesses' employee relations would create *market incentives* for businesses to improve their employee relations.

Policy Recommendation 7: Tax Credit for Employee Handbook

A California business will be granted a \$500 tax credit if it:

- 1) has an employee handbook for all workers in California that explicitly covers five major areas:
 - a. complaint and grievance rights;
 - b. rights involving the procedures and nature of discipline;
 - c. job security, including procedures and permissible reasons for dismissal;
 - d. rights concerning promotion, career advancement, and training;
 - e. rights concerning eligibility for insurance, pensions, leave and other benefits;
- 2) has an employee handbook that includes a statement that the handbook is a binding and enforceable contract that limits the behavior of the business;
- 3) provides a copy of this employee handbook to all current California-based employees;
- 4) agrees to provide copies of its employee handbook to all future employees and all people considering job offers from the business; and

- 5) submits a copy of this employee handbook to the California Department of Industrial Relations (DIR). The DIR will then make copies of these handbooks easily accessible to the public via an Internet Web site.

Although this tax credit program will be ongoing, a business can only be granted this tax credit once. After receiving the tax credit, if a business eliminates its employee handbook within 5 years, the state would recapture the tax credit.²⁶

This policy gives businesses complete choice about what rights their employees have, with the simple requirement that these rights be made explicit and transparent to their employees. The policy does not infringe on the rights of employers to establish their own employee relations.

This policy rewards businesses with already existing employee handbooks. It also provides an incentive to introduce an employee handbook where one did not exist before. In this way, the policy serves to reduce the short-run costs of switching to better employee relations. Although some businesses will introduce employee handbooks that fail to grant to their workers any basic workers' rights, some businesses will use the incentive to switch to worker friendly/high performance workplaces.

In addition, this policy promotes the public dissemination of information about businesses' employee relations. Individual workers will be more able to improve the employee relations they experience by switching employers. The public dissemination of this information will also create market incentives for businesses to improve their employee

²⁶ Many of the ideas in this section are borrowed, with some major modifications, from Edwards (1993).

relations (as discussed above). Finally, this policy would help promote the reestablishment of a social and moral framework that recognizes that worker friendly employee relations are important.

Businesses that already have such a handbook need only to submit it to DIR. Businesses that do not have an employee handbook can either write their own or select one of a set of standard employee handbooks that will be produced by DIR. If a business decides to use a DIR-written handbook, a DIR form would permit a business simply to identify which employee DIR-written handbook the business is using without sending a copy to DIR.

The Department of Industrial Relations will produce a number of different versions of model employee handbooks. Each should differ in the mix of protections/rights granted to employees. Each should provide, however, a level of employee rights that provide minimum workers' rights. These model handbooks can be used by businesses that are writing or rewriting their own handbooks. Alternatively, as noted above, these model handbooks would be used by businesses that desire to do so.

Current employees of the business would benefit from this policy because the employer is forced to tell them explicitly, most likely for the first time, what rights they have and what rights they do not have. This policy would also make, for the businesses responding to the incentive, the promises made in the handbook binding to the business. The handbook must, then, truthfully state the employer's policies about their treatment of their employees.

The Department of Industrial Relations would make the employee handbooks sent to them available to the public. (This would be most easily done if handbooks were submitted in electronic form.) In addition to making these employer-submitted handbooks available on a

DIR Web site, the DIR will publish an annual study detailing the best of employee handbooks it has received along with other information about these handbooks.

Businesses applying for the tax credit would also have to fill out a form that identifies which particular rights they have granted employees.²⁷ These forms would be used to determine if the business has granted what the DIR has determined is the minimum level of employee rights consistent with the public benefits. Businesses could then be identified in a public report (perhaps produced for different industries and/or different regions) as having met these minimum standards. This public report would only identify employers with good employee relations; those with poor employee relations would not be identified as so.

Cost-Benefit Analysis 7

I will assume that in the first year of the policy, 1 out of 100 businesses (or about 10,000 businesses) respond to the tax credit. I will assume that in years 2 to 5, an additional 1 out of 250 businesses respond each year.

I will also assume that of these businesses, 25 percent will have created employee handbooks for the first time or will have substantially improved the rights they grant workers. Over the 5-year period, 26,000 businesses will have responded (or about 1 out of 40 California businesses) and 6,500 of these will newly offer employee handbooks (or substantially better handbooks). I will also assume that the businesses responding to this tax credit have, on average, 40 employees.

²⁷ For example, the form could ask, “Do employees have the right to appeal to an outside arbitrator the decisions your business makes about grievances? Yes No.”

State

If 10,000 businesses respond to this tax credit in the first year, then the total tax credits granted each year would total \$5,000,000. In each of the later years, 4,000 businesses will receive the credit and the credit will be worth \$2,000,000 in each of these years. The present value of these credits for years 2 to 5 will be \$6,900,000. These numbers appear in Table 8.

Table 8
Policy Recommendation 7
Tax Credit for Employee Handbook

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$0	\$5,000,000	- \$5,000,000
Private	\$10,000,000	\$0	\$10,000,000
TOTAL	\$10,000,000	\$5,000,000	\$5,000,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$0	\$6,900,000	- \$6,900,000
Private	\$68,300,000	\$0	\$68,300,000
TOTAL	\$68,300,000	\$6,900,000	\$61,400,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$0	\$11,900,000	- \$11,900,000
Private	\$78,300,000	\$0	\$78,300,000
TOTAL	\$78,300,000	\$11,900,000	\$66,400,000

Private Sector

Of the 10,000 businesses receiving the credit in the first year, 7,500 will get the credit for an already-existing employee handbook. Although no new workers will benefit from improved employee relations, the information in the handbooks will become public knowledge and, so, will contribute to the market incentives for businesses statewide to

improve their employee relations and will make it easier for workers to find a business with the employee relations they desire.

An additional 2,500 businesses in the first year will provide improved employee relations to their workforce. As these businesses created these handbooks voluntarily, the benefits of creating a handbook must have exceeded or equaled its cost (minus the \$500 tax credit). Although as discussed above, it would be reasonable to assume that this tax credit would provide a net benefit to employers of \$250, I will assume that the net benefit to these businesses of this incentive is zero.

In these 2,500 businesses, 100,000 workers will benefit from improved employee relations. I will assume that the value to each worker of this improvement is \$100 per year. This is, however, most likely an understatement of the benefit to workers. The collective benefit of improved employee relations, then, will be \$10,000,000. This benefit will be experienced in the current year and in future years.

In each of years 2 to 5, an additional 4,000 businesses respond to the incentive. Again, the net benefit to each business is zero for the reasons stated above. Further, 40,000 employees in 1,000 businesses in each of these years will benefit from improved employee relations because of this policy. The present value of \$4,000,000 benefit to employees in years 2 to 5 is \$68,300,000.

Net Benefit

This policy reduces the General Fund balance by \$11,900,000 (in present value terms) over the full 5-year period. The cost to business is zero as this policy is based on an incentive.

Workers benefit by \$78,300,000 (in present value terms) over the 5-year period. The net benefit to the state and the private sector is \$66,400,000.

PROMOTING WORKER FRIENDLINESS BY PROMOTING UNIONIZATION

Union workers earn about 15 percent more than they would have earned in the absence of a union (Haggerty and Leigh 1993). Union workers also are much more likely to receive pensions and healthcare benefits and to receive more valuable pension and healthcare benefit packages. All told, unions increase benefits by about 30 percent (Freeman and Medoff 1984). Unions are also associated with safer and healthier workplaces, greater employment security, and more worker friendly employee relations.

The so-called “threat effect” of unions contributes to better compensation and working conditions for nonunion workers. As previously noted, when unions are strong, many nonunion businesses pay wages higher than they otherwise would have paid in order to reduce the attractiveness of unions to their workers. The threat of unionization also provokes many businesses to provide healthcare insurance, pensions, and to improve employment security, workplace health and safety, and workers’ rights. Again, this is to reduce their workers’ interest in unionization.

The decline of unions, then, had a widespread effect on worker friendliness. Lower wages, worse benefits, worse working conditions, and less worker friendly employee relations have all followed declining union membership. Estimates also indicate approximately 30 percent of the recent rise of wage inequality in the United States is due to one single factor: the decline of unionization (DiNardo, Fortin, and Lemieux 1996).

Not surprisingly, a substantial minority of workers—perhaps 44 percent—desire union representation (Freeman and Rodgers 1999, 146). In fact, surveys indicate that about

five million workers in California want the benefits provided by unions.²⁸ This five million total is greater than the number who voted for Gray Davis in the last gubernatorial election.

Unions, however, have found it increasingly hard to get workers to act on their desire to benefit from union representation. Studies show that two factors are responsible for this situation:

- 1) aggressive pre-union election campaigns by management in which management makes it clear that it would make the workplace unpleasant if workers voted in a union (Rodgers and Freeman 1999), and
- 2) occasional illegal management tactics—for instance, the firing of union supporters—during unionization drives that intimidate potential union supporters (Flanagan 1987).

These two strategies are so effective, many workers who would like a union to represent them vote against one when given the chance. According to Freeman and Rodgers (1999, 87),

Some 12 percent of workers who said they would vote anti-union told us they would vote pro-union if management was not hostile to the union; some 8 percent of pro-union voters said they would change their vote and oppose the union if management was opposed to the union. Because NLRB representation elections are often won or lost by swings of 5-10 percent of the vote, these numbers are enough to change the outcomes of many such NLRB elections.

Management hostility toward unions is, of course, legal.

²⁸ I generated this estimate by using the approach of Gordon (1996, p.243) and employment data from the Employment Development Department.

However, some businesses go beyond this: they willingly violate state and federal labor laws when these violations intimidate potential union supporters. These businesses engage in such illegal activity for a simple reason: the benefit of this illegal activity is large and the cost for violating labor law is small. By law, the National Labor Relations Board is permitted to use only remedial (rather than punitive) corrective actions: it can only restore the status quo before the illegal activity. Many businesses have decided that it is best to illegally fire an influential worker advocating unionization—and stopping a unionization drive in its track—if the only possible punishment they face (perhaps 3 years down the road) is being forced to give this illegally-fired worker back pay and an offer of reemployment.

Part of management's motivation for using these two highly successful strategies for defeating unions is to protect the profitability of the business. Although research is not yet conclusive, it does appear that unionization does reduce profitability by a modest amount.

But other motivations exist for management's aggressive anti-union campaigns. Interviews with managers and workers reveal that management often opposes unions because after a union is voted in management loses its unchallenged power in personnel decisions (Freeman and Rodgers 1999). This power, however, is one of the most desired attributes of a managerial job; managers often fight unions because of the threat unions have on managers' power. Further, DiNardo, Hallock, and Pischke (1997) found that a 10 percent increase in the unionization rate within a business leads to a 2 to 3 percent drop in the compensation of executives and a reduction in management employment. Management loses when unions enter the workplace.

Incentives can be established to help reverse the decline in unionization. One incentive would reward businesses that accede to their workers' demand for a union. A

second incentive would reward businesses that do *not* violate labor laws when faced with a union organizing drive.

The benefits for establishing such incentives are clear. According to Freeman and Rodgers (1999, 155),

The basic message to decision-makers in business, labor, and government is clear: A huge opportunity exists for America to increase the representation and participation of workers at their jobs and thereby to improve the quality of working life. Political leaders will find potential votes for such reforms; unions will find scores of potential members; business will find a better and more loyal workforce. Of course, whether any of these groups take full advantage of this opportunity is their choice. But the right choice for private action and public policy would be to help workers gain the voice and representation in workplace decisions that they so clearly want.

Policy Recommendation 8: Tax Credit to Accept Union

A one-time \$10,000 tax credit would be provided to all businesses that agree to newly recognize a union as the bargaining representative of its employees. Because, in some businesses, different unions represent different groups of workers, a business could conceivably recognize numerous unions and receive numerous credits. This is unlikely to occur very often, however.

This tax credit would be available for a business that meet two criteria: a) it recognizes the union *before* a representation election is held and b) it recognizes the union within 14 days of a request by a union for such recognition or before a petition for Certification of Representative is filed with the National Labor Relations Board.

This short time before the business must accept the union (two weeks) is necessary so that businesses that accept this tax credit are not merely giving in to the inevitable—they know the union will win the election for sure. Two weeks is generally not enough time to carry out an effective anti-union campaign or to determine who will win the election. Most

elections are determined by a handful of votes and the outcome of most elections is unknown until the ballots are counted. Many of the businesses accepting this tax credit, therefore, might have actually defeated the union if they had tried. The goal of the policy is to reward businesses that do give up the chance to fight, and perhaps beat, the union.

Once given, this tax credit would be recaptured if the business and union are unable to agree on a contract within one year after the union is recognized. Unions quite frequently fail to get a first contract from their employer because of their employer's refusal to bargain in good faith. This recapture aspect of the policy will exclude businesses that plan to accept the union in order to get the tax credit and, then, to refuse to reach a contract agreement with the new union.

This policy does not infringe on the right of a business to have an election or to fight the attempt of their employees to form a union. It simply provides an incentive for a business to voluntarily accept a union as the legal bargaining representative of its workers and to negotiate a contract with their union.

Cost-Benefit Analysis 8

In California, about 500 union elections occur in a typical year. These elections involve about 25,000 workers. Unions typically win about half these elections.

Management's interest in voluntarily accepting a union in order to gain a tax credit is unknown. With a \$10,000 tax credit, I will assume that a business decides to accept a union voluntarily, and take the tax credit, in 1 out of 20 elections. With 500 elections occurring each year, about 25 businesses would take the credit annually. However, the union would have won about 50 percent of these elections even if the business had not accepted the union voluntarily. Therefore, I will assume that 13 new unions will be created by this policy. If

each new union local typically has 50 members, this would be an addition of 650 workers to union rolls each year due to this policy.

State

If 25 businesses take advantage of this policy each year, the total tax credits granted would equal \$250,000 annually. Table 9 shows this cost to the state.

Table 9
Policy Recommendation 8
Tax Credit for Accepting Union

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$0	\$250,000	- \$250,000
Private	\$2,600,000	\$0	\$2,600,000
TOTAL	\$2,600,000	\$250,000	\$2,350,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$0	\$870,000	- \$870,000
Private	\$37,400,000	\$0	\$37,400,000
TOTAL	\$37,400,000	\$870,000	\$36,530,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$0	\$1,120,000	- \$1,120,000
Private	\$40,000,000	\$0	\$40,000,000
TOTAL	\$40,000,000	\$1,120,000	\$38,880,000

Private Sector

Union members receive approximately a 15 percent increase in wages due to their union membership. As the average earnings for production workers is about \$17,000 per year, the annual union wage increase per worker is \$2,550.

Some of these workers will also benefit from healthcare insurance and pensions as unions frequently negotiate these benefits for their members. I will assume that 35 percent of the new union workers newly receive healthcare insurance and 35 percent newly receive an employer-provided pension.²⁹ Some workers will be in unions that are unable to negotiate these benefits. Other workers would have already had these benefits before the union was voted in. As above, I will assume the average contribution for employers to healthcare insurance is \$1,500 and that the average contribution for pensions is \$2,000. The average increase in benefits for these newly organized union workers will be \$1,225. (This is equal to $0.35 \times 1,500 + 0.35 \times 2,000$).

Finally, I will assume that the total value to these workers because of union-negotiated improved health and safety conditions, employment stability, and worker friendly employee relations is \$250 annually.

Each newly unionized worker, then, benefits by \$4,025. Every year 650 more workers become unionized because of this policy. (An additional 650 workers within businesses accepting the tax credit also become unionized but, by assumption, they would have become

²⁹ This is the percentage increase in healthcare coverage for union workers found by Sloan and Conover (1998).

unionized even without this policy.) And, so, every year the total benefits going to workers because of this policy is about \$2,600,000, as indicated in the relevant table.

Each new cohort of 650 unionized workers receives this benefit every year from the year they are unionized until year 5. By the fifth year, 3,250 workers will benefit from higher earnings, better benefits, greater health and safety in the workplace, greater employment security, and improved employee relations. The present value of these benefits in years 2 to 5 is \$37,400,000.

As these businesses are *voluntarily* accepting the union, it can be inferred that for these firms the cost of a union is less than the benefit from having a union. As shown in the introductory section on cost-benefit analysis, businesses that voluntarily accept the union under this policy will experience an average net benefit of \$5,000 (which is half the \$10,000 tax credit).

Each year 25 new firms accept this credit. Therefore, each year businesses gain \$125,000. To simplify the analysis, however, I will assume the net benefit (net cost) to business is zero because of this policy.

Net Benefit

The state experiences a (present value) loss equal to \$1,120,000 over this 5-year period. The benefit to workers is \$40,000,000 while the business experience no addition costs from their voluntary acceptance of the union. The net benefit to California as a whole is \$38,880,000.

Policy Recommendation 9: Tax Credits Only to Businesses Not Breaking Labor Laws

Businesses that do not violate state or federal labor law will have access to all California state income tax credits. A business found by its actions in California to have

violated state and/or federal labor laws, however, will not be able to claim any California state income tax credit for a period of 3 years from the date of the illegal action. Relevant state or federal labor courts will determine if such violations occurred.

This policy increases the cost of violating state and federal labor laws. As discussed above, the cost of violating labor laws is very low and, as a result, many businesses do not take enough care to avoid violating these laws.

Because of the lengthy time between the violation of labor laws and the finding that a business did violate these laws, many businesses will have (in retrospect improperly) claimed tax credits on their California state income tax during the 3-year period they were prohibited from claiming such tax credits. In this case, these improperly claimed tax credits would be recaptured by the state.

Cost-Benefit Analysis 9

The above policy will give businesses an incentive to avoid willingly violate state or federal labor laws. By increasing the incentives to follow existing labor law, this policy will reduce the use of illegal methods by businesses for fighting unionization drives and the frequency of bad faith bargaining by businesses during contract negotiations. As a consequence, the policy will provide greater protection for workers to express their legal rights to join a union. More unions should become certified in union elections and more unions should be able to successfully negotiate contracts.

National Labor Relations Board data indicates that approximately 1 out of 130 businesses with more than 20 employees is forced to remedy behavior found to be illegal under existing labor law. In addition, about 10,000 corporations in California annually

receive tax credits from the state. If these two ratios are independent, then about 80 California businesses receiving tax credits also were found to be in violation of labor laws.³⁰

Businesses often violate labor laws to avoid a union contract. I will suppose that one-half of these 80 California businesses that both receive tax credits and violate labor law successfully keep out a labor union from their business (or keep the union from successfully negotiating a contract) *because of* their violations of labor law.

The proposed policy will change business behavior. I will assume that of these 40 businesses, 20 will respond to the new incentive to not violate labor laws. Twenty businesses, then, will become unionized and twenty businesses will lose tax credits under this policy. However, the twenty businesses that become unionized do not voluntarily accept the union. They just no longer use illegal methods to fight the union and, in their cases, find the union wins the election.

The average newly organized union has about 50 workers. Therefore, if 20 businesses become unionized annually because of this policy, about 1,000 workers each year will become union members.

State

The costs to the state to administer this incentive program will be nominal. Tax authorities can merely compare a list of businesses violating labor law with a list of businesses who have received tax credits over the relevant time period.

The monetary benefit to the state will be reduced tax expenditures. If, as assumed, 20 businesses are found annual to be subjected to the loss of tax credits, then the state will

³⁰ $10000 \div 130 = 80$

recapture or not grant tax credits to these 20 businesses. If the average business receiving a tax credit also receives it the following year, then this policy will lead the state to recapture these second year tax credits also.

The average tax credit earned by California corporations is approximately \$100,000. In this case, the recaptured or not granted tax credits from these 20 businesses would be worth \$2,000,000 annually to the state. If these businesses would have received the same tax credit the following year, then tax expenditures would fall by \$2,000,000 that year also. In each of years 2 to 5, state reductions in tax expenditures would drop by \$4,000,000. The present value of these reduced expenditures in years 2 to 5 equals \$13,900,000. These costs appear in Table 10

Table 10
Policy Recommendation 9
Tax Credits Only if a Business Does Not Violate Labor Laws

Sector	Benefits	Costs	Benefits – Costs
<i>First Year</i>			
State	\$2,000,000	\$0	\$2,000,000
Private	\$4,000,000	\$2,700,000	\$1,300,000
TOTAL	\$6,000,000	\$2,700,000	\$3,300,000
<i>Years 2 to 5: Discounted Present Values</i>			
State	\$13,900,000	\$0	\$13,900,000
Private	\$47,800,000	\$22,400,000	\$25,400,000
TOTAL	\$61,700,000	\$22,400,000	\$39,300,000
<i>Complete 5-Year Period: Present Discounted Value</i>			
State	\$15,900,000	\$0	\$15,900,000
Private	\$51,800,000	\$25,100,000	\$26,700,000
TOTAL	\$67,700,000	\$25,100,000	\$42,600,000

As these tax credits would most likely be recaptured after-the-fact, the activity that led to the tax credit would have occurred even those the business retroactively lost the tax

credit. This recommended policy should not, then, led to a fall in the behavior the relevant tax credit was designed to reward.

Private Sector

Each year 1,000 new workers become union members because of this policy. As above, I will assume that the average value of union membership is \$4,025. For these workers, the collective annual benefit due to this policy is \$4,025,000. Each year a new cohort of 1,000 workers receives this annual benefit from the year they are unionized until year 5. By the fifth year, 5,000 workers will benefit from higher earnings, better benefits, greater health and safety in the workplace, greater employment security, and improved employee relations.

Table 10 shows that the present value of all these gains to workers in years 2 to 5 is \$47,800,000. The total present value of the benefits to workers over the full 5-year period is \$51,800,000.

Because employers did not voluntarily accept these unions, it stands to reason that the costs of a union exceeded the benefits of a union to these businesses. The net cost that businesses experience for the arrival of unions appears primarily in the form of lower profits.³¹

The total cost to businesses of a union, however, is not equal to the increased cost associated with unions. Research has shown that unions are associated with increased

³¹ But, as discussed above, management also loses their unchallenged power in the workplace and might also experience lower pay become of a union. I will not, however, take account of these two effects of unions as they are, arguably, positive impacts.

productivity and that this increase productivity (partially) counteracts the increased costs that come along with a union. If the productivity gain is large enough, then even with increased costs a unionized business would not necessarily experience lower profits.

The consensus, however, is that union-caused productivity increases do not completely counteract union-increased costs. According to Voss and Mishel (1986), unions reduce profitability by about 20%.³² But what is the dollar amount associated with this decline in profits? National Income and Product Account data indicate that profits equal about 15 to 20 percent of labor compensation. Further, the average production worker earns about \$20,500 in compensation each year.³³ This implies that the profit earned per production worker is approximately \$3,588. This latter sum is: $\$20,500 \times 0.175$.

If unions reduce profitability by 20%, then the appearance of a union in a firm should reduce the profit per worker from \$3,588 to \$2,870, a loss of \$718 in profit per worker. If 1,000 workers become unionized by this policy, then the total cost to businesses would be \$718,000 per year. And, of course, each new cohort of union workers would have the same negative impact on businesses profitability from each year they are unionized until the end of the 5-year period considered.

³² This is an average. Some businesses will experience greater losses and others will actually experience increased profits. These latter firms are those who might be inclined to accept a union voluntarily (if they ignored the loss to managements' power and income).

³³ As nonwage compensation generally equals 20 percent of earnings, total compensation for production workers is $1.2 \times \$17,000$. The latter is the average earnings for production workers used previously in this report.

In addition, 20 other businesses will lose the tax credits they had previously received or were otherwise eligible for. The value of the tax credits lost by these businesses equals the reclaimed tax credits of the state: \$2,000,000 in the first year and \$4,000,000 in years 2 to 5.

The above table shows that the loss to business in the first year of the policy equals approximately \$2,700,000. The present value of the costs to businesses in years 2 to 5 equals \$22,400,000. The total loss to businesses over the 5-year period has a present value of \$25,100,000.

Net Benefit

As seen in Table 10, the net benefit to all of California is \$42,600,000. The state General Fund is improved and workers' gain is \$51,800,000 in present value terms. Business losses are valued at \$25,100,000 in present value dollars.

SUMMARY

Table 11 (following page) presents an overview of the costs and benefits of the policy recommendations made in this report. Excluded from this table, however, is policy recommendation 6, related to health and safety issues, which recommended the status quo.

The policies are listed according to how much they help California's working families. Policy recommendation 5, the unemployment insurance tax rate change proposal, brings the largest benefit to California's working families (\$178.6 million). Policy recommendation 3, an outreach program informing small businesses about the HIPC program, brings the smallest benefit (\$4.5 million).

Table 11
Summary of Policy Recommendations: Five-Year Horizon, Present Discounted Value
(Present Discounted Dollar Values in Millions)

Policy Recommendation	Benefit to Working Families	Cost to Business	Change in General Fund	Net Benefit to California
PR 5 – Unemployment Insurance Tax Rate Changes	\$178.6	\$8.5	\$8.9	\$179.0
PR 7 – Tax Credit for Employee Handbook	\$78.3	\$0	- \$11.9	\$66.4
PR 4 – Support Fed Pension Initiatives/Pension Information Program	\$67.0	\$0	- \$0.5	\$66.5
PR 9 – Tax Credit Lost if Labor Laws are Violated	\$51.8	\$25.1	\$15.9	\$42.6
PR 8 – Tax Credit for Accepting Union	\$40.0	\$0	- \$1.1	\$38.9
PR 1 – Living Wage Incentive for Local Communities	\$36.3	\$36.3	\$10.1	\$10.1
PR 2 – Employee Tax Credit for Healthcare Insurance	\$5.6	\$0	\$3.7	\$9.3
PR 3 – HIPC Information Program	\$4.5	\$0	\$2.9	\$7.4

A comparison of the first two columns of numbers, Benefit to Working Families and Cost to Business, indicates the extent to which the policies are based on income redistribution. As seen, the benefit to working families far exceeds the cost to business in almost all the recommended policies. Only one policy—policy recommendation 1, the Living Wage Incentive for Local Communities—is based on straight income redistribution.

I should point out, however, that I consistently underestimated the benefit that employers receive from the various policies recommended above. Many of the “\$0” cost estimates appearing in Table 11 should really be negative numbers. That is, businesses will actually benefit from many of the policies proposed in this report.

All of the policies have only a minor impact on the General Fund. Further, whenever a policy leads to a worsening in the General Fund balance, the gains to California’s working families far exceeds the negative impact on the state budget.

Finally, all these policies lead to a net benefit for all of California. This net benefit to California, which takes account of the gains to working families, the losses to businesses, and the change in the General Fund, appears in the last column.

The policies recommended above would lead to substantial improvement in worker friendliness. The costs of these policies to business, on the other hand, are small.

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APPENDIX: CRITIQUE OF DRAFT LEGISLATION

Assembly staff has already drafted a proposal for “Incentives to Encourage More Worker Friendly Corporations in California” (see Attachment). The draft legislation is titled *California’s Working Families Act*.

The draft legislation has many laudable characteristics. Most notably, it puts under a single umbrella a set of concerns—low wages, poor pension coverage, declining healthcare coverage, employment insecurity, and so on—that have often been addressed individually but which are most effectively addressed in a unified and coherent policy. The draft legislation is such a unified and coherent policy.

The draft legislation also has a number of weaknesses. I will address only the most significant of them below.

First, although the draft states that it includes a “set of comprehensive steps to address wage and income stagnation” nothing in the draft policy directly addresses wage or income stagnation. The failure of the draft policy to address this stagnation is a major weakness.

Second, the value of the incentive received by businesses in the draft legislation is not closely related to the level or the increase in the level of worker friendliness within the business. Instead, the value of the incentive received by worker friendly businesses is linked to the level of investment made by the business. It is not clear, however, why a business with \$10,000,000 a year in investment deserves to be more highly rewarded for being worker friendly than a business that invests only \$500,000 a year. This is particularly true if both businesses had, say, 400 workers. (Such a difference in investment for two businesses with the same number of employees could occur if one of the businesses was an expanding manufacturing business while the other was a nonexpanding retail business.)

Third, the estimated cost of the draft legislation is extremely high. The Franchise Tax Board estimated that the cost of the proposed tax credit would be 1.2 billion dollars (Franchise Tax Board 1998).³⁴ To put that dollar value into perspective, the total value of *all* tax credits allowed to banks and corporations in 1996 was only 0.9 billion dollars. In the same year the total tax liability for banks and corporations was only 4.9 billion dollars. The proposal legislation, then, would double the tax credits allowed to corporations and would lead to a decline of tax liability of corporations to the State of California of perhaps 20 percent. The draft legislation would grant this tax credit every year.

Fourth, despite its high cost, the draft proposal might do little to *increase* the number of worker friendly businesses in California. The reason is simple. In the draft proposal, California businesses are not eligible for the proposed incentives unless they meet a long list of relatively stringent standards. For the most part, only businesses that are just short of meeting these standards will strive to become (yet more) worker friendly. Businesses that fall far short of these standards will find the long list of worker friendly standards too burdensome to achieve. They will, therefore, not respond to the incentives. Businesses that are far short of being worker friendly should be a primary target of this policy; they should be rewarded for taking the *first steps* toward becoming worker friendly. The proposed legislation rewards *last steps* of businesses that are already worker friendly.

It is unlikely, then, that the benefits of this legislation would justify the extremely high costs. While some working families would benefit from this proposal, many other approaches for promoting worker friendly businesses in California would be more efficient.

³⁴ This is the applied part of the credit. The unapplied/carryovers would equal \$18.9 billion.

Fifth, and finally, the draft legislation assumes (falsely) that greater investment and improved productivity directly promote worker friendliness. The draft states that it seeks to “produce long-term, higher rates of economic growth shared with working families in California.” In recent years, higher rates of investment and higher rates of productivity growth have not obviously benefited working families.

One thing that clearly benefits working families is greater real compensation. *If* higher investment leads to greater compensation then we might expect to see that higher investment is associated with higher compensation.

Figure 2 shows the association between the growth in investment and real compensation growth for production workers from 1960 to 1981. This figure shows a strong association between higher investment and higher real compensation. During this period, claims that higher investment promotes higher compensation might have been reasonable.

Figure 2
Association Between Real Investment and Real Compensation
1960-1981

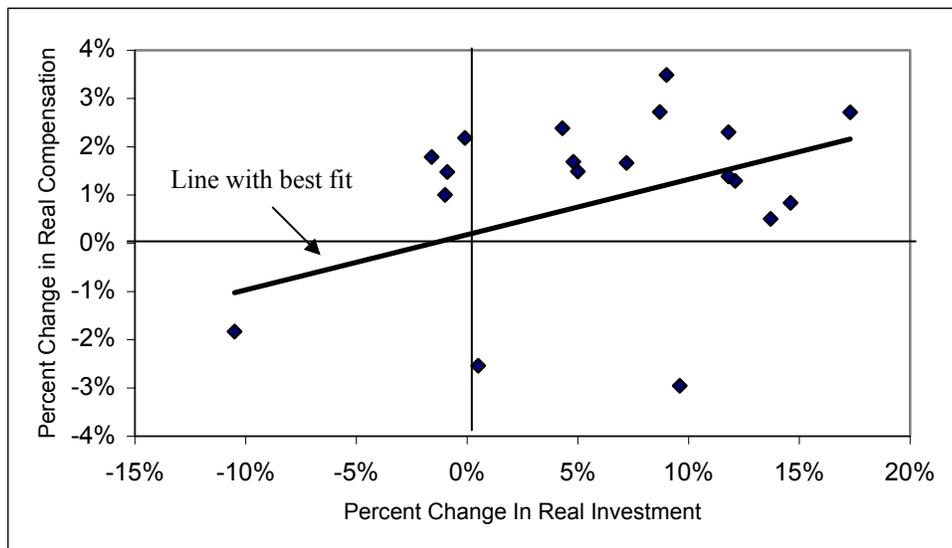
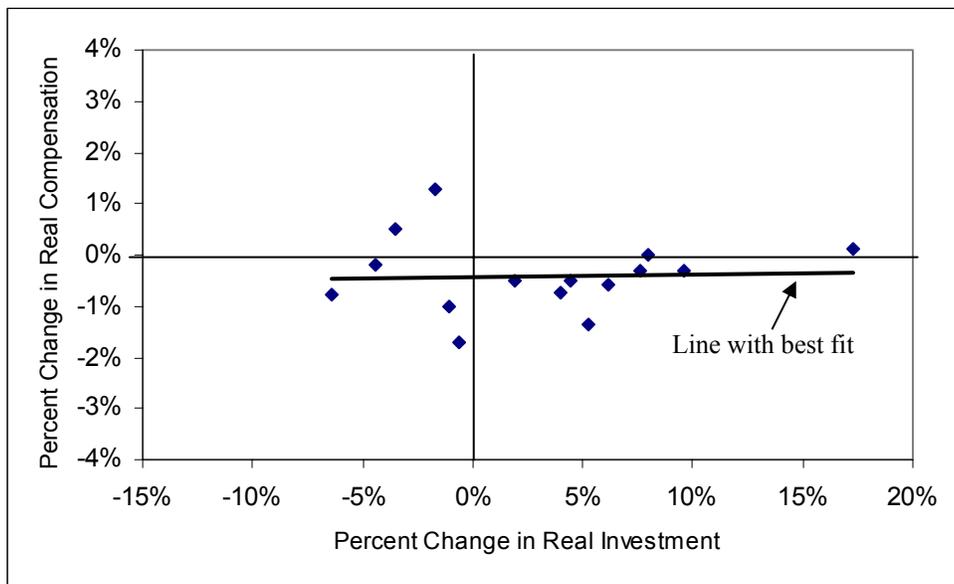


Figure 3 presents a less optimistic picture. This figure, for the period 1982 to 1995, is more relevant for the current day. It shows no association between investment growth and real compensation growth. This suggests that *policies that rely on investment promoting higher compensation are possibly misguided in the current period.*³⁵

Figure 3
Association Between Real Investment and Real Compensation
1982-1995



³⁵ The association between productivity growth and real compensation growth for production workers in the two periods is almost identical to that seen in these two figures.

ATTACHMENT: PROPOSED CALIFORNIA'S WORKING FAMILIES ACT

The following is draft legislation written by Assembly staff that is designed to promote worker friendly corporations in California. This draft legislation is critiqued in the Appendix.

SECTION 1. The California State Legislature finds and declares that:

1. California businesses are facing intense national and international competition and from investors to produce ever-larger short-term profits, and, as a result, are often forced to strategies;
2. Despite the present positive economic outlook, as a result of the short-term earnings strategies of many of the state's largest private employers, California workers are rightfully nervous and frightened about their long-term job security, access to health care, pension plans, worker training and wage rates;
3. There exists a need to create a countervailing set of incentives to enable businesses to focus on long-term strategies which include well-paid, secure employees with pension plans and access to worker training and health care.

SEC. 2. This act shall be known as the California's Working Families Act and encompasses a set of comprehensive steps to address wage and income stagnation and to produce long-term, higher rates of economic growth shared with working families in California.

SEC. 3. There is established for the purposes of taxation, regulation and state government contract treatment a business entity called the "Partnership with California's Families Corporation," or "PCF-CORP." A PCF-Corp must meet all of the following criteria:

1. Contribute an amount equal to at least three percent of its California payroll to, and offer its California employees, a highly portable pension plan. Such a plan

may be either a collectively-bargained single employer plan or a multi-employer or multiple employer plan.

2. Contribute an amount equal to at least two percent of California payroll for California employee training or education certified to meet industry group standards;
3. Provide for and pay at least half the cost of a health care plan for all California employees that conforms to a model health care benefits plan drafted by the National Association of Insurance Commissioners;
4. If a for-profit corporation, operate for its California employees either an employee profit-sharing plan, or an employee gain-sharing plan such as bonuses tied to worker productivity, quality, safety or other measurable goals, or an employee stock option plan or stock ownership plan;
5. Maintain a compensation plan such that the compensation of the highest paid employee is not greater than fifty times that of the lowest paid full-time employee;
6. Show that in the preceding three-year period:
 - a. At least 50 percent of the total of all net new investment in research and development was made in California; and
 - b. At least 90 percent of the total of all net new investment in plant, equipment, and employment used for the production and delivery of products and services consumed in California occurred in California;
7. Is not found to be in violation of a final order/decision of the National Labor Relations Board, or any other labor law violations within the jurisdiction of the State Department of Industrial Relations;

8. In the last three years, has had no serious health and safety violations which resulted in the death or serious injury of a worker.

SEC. 4. There is established the Commission on Business and the California Family within and staffed by the Trade and Commerce Agency composed of nine members; including three representatives of business; three representatives of labor; and three at-large members who shall be from working families.

1. The Governor, Senate Rules Committee and the Assembly Speaker will each appoint three members of the Commission, one from each subgroup.
2. The Commission will establish methods for determining whether corporations applying for PCF-Corp status meet the specified criteria and make recommendations to the Legislature as in its view specific criteria become inoperative, irrelevant or otherwise no longer fulfilling the intent of this Act.
3. The Commission will report to the Legislature as to how specified PCF-Corps tax, regulatory and contract incentives are functioning and suggest changes to make them more effective in meeting the goals of this Act.

SEC. 5. Corporations which are deemed by the Commission to have attained PCF-Corp status shall be entitled to the following corporate tax benefits:

1. Research and development investments made in California receive an additional three percent tax credit over the existing tax credit for research and development investment;
2. Investments in plant, equipment and employment made in California are fully deductible from state corporate taxes;

3. Employer's share of health-care plans and pension plans made on behalf of its employees receive a twenty-five percent tax credit.

SEC. 6. Corporations which are deemed by the Commission to have attained PCF-Corp status shall be required to comply with all state laws and regulations, but are entitled to:

1. Speedy state agency review and decision making;
2. Participate in voluntary compliance programs;
3. Take advantage of safe-harbor provisions designed for PCF-Corps from applications of certain regulatory requirements.

SEC. 7. Corporations which are deemed by the Commission to have attained PCF-Corp status shall be entitled to a strong preference including a 10% cost-advantage, set asides, goal provisions and other similar provisions in competitions for California procurement contracts, awards and other programs in which businesses are allowed to participate.