The Many Faces of Mandates: Beyond Traditional Accommodation Mandates and Other Classic Cases

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YORAM MARGALIOTH*

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I. INTRODUCTION

Society uses two competing social policy tools to enhance the welfare of its workers: mandated benefits and tax-financed programs. Mandated benefits are benefits that employers are legally required to provide to their workers, such as parental leave. Tax-financed programs are benefits provided by the government to employees that are financed by a targeted labor tax.

The use of mandated benefits has dramatically increased over the last twenty years; mandated benefits are "coming from every different angle"[1] and "are virtually omnipresent in modern employment law."[2] However, these benefits are often predicated on mistaken beliefs regarding their economic effects.[3]

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    1.   Frank B. McArdle, *Introduction: The Pressure for New Legislated Mandates*, *in* GOVERNMENT MANDATING OF EMPLOYEE BENEFITS xxv, xxv (1987).
    2.   Christine Jolls, *Accommodation Mandates*, 53 STAN. L. REV. 223, 225 (2000).
    3.   *See, e.g.*, John J. Donohue III, *Understanding the Reasons for and Impact of Legislatively Mandated Benefits for Selected Workers*, 53 STAN. L. REV. 897, 908–09 (2001).

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One major reason for the proliferation of mandated benefits is the naive belief that they are capable of redistributing wealth from employers to employees. Lawrence Summers refuted this belief in a paper recognized as the seminal work on the subject of mandated benefits.[4] He explained that employers shift the costs of providing the benefits to their employees by reducing wages or by offering employees lower fringe benefits. But Summers's paper, and the literature that followed it, gave an impression that mandated benefits might be better in a certain respect than tax-financed programs.

According to this literature, mandates may produce less distortion than tax-financed programs. A critical assumption behind this idea is that tax-financed programs have a particular design, namely that participation in them is not limited to employees. For some issues, such as health care, this is almost certainly the most plausible assumption. Yet, it is not clear why the government should impose taxes on employees to finance benefits for nonemployees instead of using a general tax that would be borne by all taxpayers. Such a tax would spread the costs of redistribution more equally among all members of society according to their ability to pay.[5] For other issues, such as parental leave, the assumption that

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> It would seem that voters would have to be ignorant and legislators would have to be either ignorant or venal to enact such universal mandates. . . .
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>   . . . .
>   . . . If universal mandates are enacted when it is relatively easy to see they will accomplish nothing, what would we expect of accommodation mandates that would be expected to harm their intended beneficiaries?. . . [T]he more complicated the chain of causal inference, the less likely are group members to perceive that something that on its face would appear to be beneficial will in fact be harmful.

Id. For similar points, see also John T. Addison & Barry T. Hirsch, *The Economic Effects of Employment Regulation: What Are the Limits?*, *in* GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 125, 125–26 (Bruce E. Kaufman ed., 1997); MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY: RETHINKING AMERICAN SOCIAL INSURANCE 294 (1999).

> [W]hen taxes are levied or payments otherwise required from employers, individual workers usually bear the burden of these payments, even if the workers don't see it that way. Politicians often also ignore this basic economic truth in an effort to reap political gain from masking the tax burdens of employees. To a politician confronted with the necessity to raise revenue, the best tax is one that everyone thinks someone else is paying.

Id.; Jolls, *supra* note 2, at 226–27.
    4.   Lawrence H. Summers, *Some Simple Economics of Mandated Benefits*, 79 AM. ECON. REV. 177 (1989).
    5.   *See* RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 61–73 (1959) (providing a classic presentation of the ability-to-pay

participation in the tax-financed program is not limited to employees seems potentially unreasonable.

Summers fully recognized the role of this assumption in his argument. At one point, he wrote:

> [S]uppose that the public parental leave program was exactly tied to the number of hours an employee worked in the past and to his or her wage. In this case, with rational employees, the program would not be distortionary because the extra parental leave one would get by working more hours would offset the extra tax payments. Mandated benefits have effects paralleling benefit tax-financed public programs. Without close links between taxes and benefits, that tend to be lacking in public programs, large distortions can result.[6]

Summers may be right in asserting that public programs lack close links between taxes and benefits in some important circumstances. However, in other programs, such as parental leave—an example Summers himself uses—such links will often exist.

The way in which academic literature has dealt with Summers's paper ignores the source of difference in efficiency between mandated benefits and tax-financed programs and makes a general assumption that mandated benefits are more efficient. Tax-financed programs are perceived to entail a "deadweight loss" that does not exist in mandated benefits.[7]

The first argument made in this Article is that there is no fundamental difference in efficiency between tax-financed programs and mandated benefits, as they are both susceptible to the same type of deadweight loss and can both be equally efficient. Any difference in efficiency between the two social policy tools is the outcome of a specific design that is most likely intended. Policymakers may often use taxes to promote redistribution goals. If tax-financed programs are used for such a purpose while mandated benefits are not, it is obvious that the former involves greater distortion than the latter.

This does not mean, however, that mandated benefits are superior to tax-financed benefits. When evaluating social policy tools, society must consider both efficiency (minimizing distortions) and equity (redistribution to enhance equality).[8] Tax-financed programs may be more distortive

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approach). *See generally* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967) (pointing out the importance of including all sources of income in the tax base).

6. Summers, *supra* note 4, at 181.

7. *See, e.g.*, Jonathan Gruber, *The Incidence of Mandated Maternity Benefits*, 84 AM. ECON. REV. 622, 622 (1994) ("Aside from their political attraction, there may be an efficiency argument for mandates, relative to public expenditure, as a means of financing benefit expansions. As highlighted by Lawrence H. Summers (1989), publicly financed benefits require an increase in government revenue-raising, with the resulting deadweight loss from taxation.").

8. One might alternatively consider *efficiency* to include redistributive goals by viewing efficiency as the maximization of a social welfare function.

because of their specific design, but considering this as an advantage while ignoring redistribution effects leads to a meaningless policy analysis. Rather, the inefficiency may be a price that society is willing to pay for redistribution that maximizes society's social welfare function.[9]

The second argument made in this Article explores the possible unintended redistribution effects of mandated benefits. Christine Jolls has shown that if the restrictions on wage and employment levels imposed by antidiscrimination laws are binding, mandated benefits may redistribute wealth from all employees to the group of employees that is protected by the antidiscrimination laws.[10]

This Article will show that certain mandated benefits, such as pension vesting and overtime pay rules, might have an opposite effect. If restrictions on wage and employment differentials hold, then groups we would normally want to redistribute to, such as women and lower compensated employees, will be made worse off.

To understand the analysis in this Article, the reader first needs some background on how mandated benefits affect wages and employment levels. Therefore, Part II will assess a number of cases that will be important in analyzing the arguments made later in this Article.

Part III covers another introductory issue—the justification for the government's intervention in the labor market. This Part will make two novel points that are not part of the Article's main arguments. These two points criticize a common argument made in both the economic and legal literature:[11] If employees' wages decrease by an amount that is equivalent to the full cost of the provided mandated benefit, so that the employment level does not decrease after the enactment of the mandated benefit, it is a sign that the enactment was efficient.[12] This is referred to as the level-of-

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9. *See* Louis Kaplow, *The Optimal Supply of Public Goods and the Distortionary Cost of Taxation*, 49 Nat'l Tax J. 513, 520 (1996) ("Knowledge that the aggregate reform—the public good and the tax adjustment, taken together—causes distortion thus provides little guidance, because the existence of distortion is associated with greater redistribution."); Joel Slemrod & Shlomo Yitzhaki, *Integrating Expenditure and Tax Decisions: The Marginal Cost of Funds and the Marginal Benefit of Projects*, 54 Nat'l Tax J. 189, 199 (2001) ("[N]either the distributional impact of proposals nor the behavioral response to them should be ignored."). *See generally* Arthur M. Okun, Equality and Efficiency: The Big Tradeoff (1975).
10. Jolls, *supra* note 2, at 243–55.
11. *See, e.g.*, Dwight R. Lee, *Teaching Tools: Why Workers Should Want Mandated Benefits to Lower Their Wages*, 34 Econ. Inquiry 401, 402 (1996).
12. *See generally* Jonathan Gruber & Alan B. Krueger, *The Incidence of Mandated Employer-Provided Insurance: Lessons from Worker's Compensation Insurance*, *in* 5 Tax Policy and the Economy 111 (David Bradford ed., 1991).

employment test. The argument is considered to be counterintuitive because one might usually believe that employees are better off if employers are not able to shift the costs of the mandate to them.

A classic example is the ongoing debate over Social Security. The tax is equally divided between employers and employees, yet many people already know that the legal division of the cost is irrelevant because the burden will be borne according to the relative elasticities of supply and demand for labor. But most of those better educated people, including many politicians, believe that employees are better off—given relative elasticities of supply and demand for labor—if employers bear most of the tax. Employers are perceived as bearing the tax burden if wage rates do not decrease, but this intuitive view is, in fact, misguided. If employees bear the full cost, it is a sign that the employees value the benefit more than its cost. Hence, the benefit is efficient and increases employees' welfare.

The first criticism of the level-of-employment test is that, because the labor supply tends to be relatively inelastic, it might be difficult to realistically distinguish between the following: (1) a case in which the wages decreased by almost the full cost of the mandate because the employees placed a high value on the mandate, meaning that the mandate was efficient, and (2) a case in which the wages decreased by the full cost of the benefit, not because of the value that employees placed on the benefit, but merely because of the relative inelasticity of the labor supply.[13]

The second criticism is that a mandated benefit might be efficient even if employees value the benefit provided to them at less than its cost (hence employment level decreases) if the benefit had been enacted to overcome an externality or if its underlying rationale was paternalism or stemmed from the employees' lack of information. In these situations, a mandate may fail the level-of-employment test mentioned above yet be perfectly efficient.

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13.   In a theoretical analysis employing graphs, any slope will yield employment effect. Because it is not plausible that the labor supply would be perfectly inelastic, a change in the employment rate is a good proxy for the efficiency of the mandated benefit. In real life, we do not see graphs, and measuring the costs of providing the benefits might be difficult at times. Thus, if the labor supply is relatively inelastic—as we know the case to be—we may find it difficult to ascertain whether or not the wages fell by their full cost. *See* Alan B. Krueger, *Observations on Employment-Based Government Mandates, with Particular Reference to Health Insurance*, *in* LABOR MARKETS, EMPLOYMENT POLICY, AND JOB CREATION 297, 311–12 (Lewis C. Solmon & Alec R. Levenson eds., 1994) (assuming labor supply elasticity to be .1, with labor demand elasticity to be -.5 in the insured sector and -.25 in the uninsured sector); *cf*. DANIEL S. HAMERMESH, LABOR DEMAND 135 (1993) (noting that employment demand elasticity is probably bracketed –.15 and –.75, with -.3 being a "good 'best guess'"). Elasticity of demand is a negative number, indicating that demand falls as the wage rate rises.

Readers who are familiar with the literature on mandated benefits and who have a basic understanding of labor economics are strongly encouraged to skip Part II and to consider skipping Part III before going on to this Article's main arguments beginning with Part IV.

Part IV compares mandated benefits and tax-financed programs, finding that both tools involve similar *excess burden*—deadweight loss—thus stressing the point that Summers must have assumed a lack of close links between taxes and benefits. Part V analyzes the redistributive effects from employers to employees that mandated benefits might have. Part VI discusses the interemployee redistributive effects that accommodation mandates may entail. Part VII provides a few examples of certain types of mandates that usually would conform to Jolls's definition of accommodation mandates, but that seem to go beyond the traditional accommodation mandates due to perverse redistribution effects. The final Part presents a unifying theme and offers some concluding remarks.

A. Two Notes Regarding Methodology

First, in order to fully evaluate the effects of mandated benefits on the labor, capital, and product markets, a *general equilibrium analysis* is required. Such an analysis takes into account the ways in which the various markets are interrelated.[14] However, general equilibrium analysis is complicated, and some important insights can often be learned from the relatively simple analysis of supply and demand curves in one market, holding all other forces constant. This type of limited analysis is termed *partial equilibrium analysis* and is commonplace in law and economics articles.[15]

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14. *See generally* Lars Bergman, *The Development of Computable General Equilibrium Modeling*, *in* GENERAL EQUILIBRIUM MODELING AND ECONOMIC POLICY ANALYSIS (Lars Bergman et. al. eds., 1990).

15. *See* HARVEY S. ROSEN, PUBLIC FINANCE 271–79 (6th ed. 2002) (discussing partial versus general equilibrium analysis in the context of taxation); *see also* EDWARD E. ZAJAC, POLITICAL ECONOMY OF FAIRNESS 18 (1995) (noting that partial equilibrium analyses "form the bulwark of applied economics"). The use of partial equilibrium analysis is especially appropriate here because this Article analyzes industries and mandated benefits in general; therefore, it is plausible to assume that competitive markets do not allow for significant shifting of costs to consumers or curtailment of employers' profits. Analysis of a specific labor market, such as the fast food industry, may require general equilibrium analysis. Moreover, a transition to general equilibrium analysis may only affect our conclusions quantitatively by making the effects smaller, but will not have qualitative effects. *See* Jolls, *supra* note 2, at 239.

Second, the use of the standard economic theory, according to which a mandate that does not reduce wage rates reduces the employment level, may be subject to criticism based on findings of two prominent economists, David Card and Alan Krueger. Their work, based on empirical findings, challenges the conventional theory that minimum wage laws increase unemployment rates.[16] Much debate surrounds the accuracy of the empirical methodologies that Card and Krueger used. As for the theory, most economists believe that the conventional assumption is still valid. However, they believe that small increases in the minimum wage may not necessarily increase unemployment, as long as the minimum wage does not exceed fifty percent of average hourly earnings and rates of economic growth, labor productivity, level of profits, and elasticity of demand for young workers do not change.[17]

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16. *See generally* DAVID CARD & ALAN B. KRUEGER, MYTH AND MEASUREMENT: THE NEW ECONOMICS OF THE MINIMUM WAGE (1995); David Card & Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply*, 90 AM. ECON. REV. 1397 (2000). *But see* Ronald G. Ehrenberg, *Review Symposium: Myth and Measurement: The New Economics of the Minimum Wage*, *Editor's Introduction*, 48 INDUS. & LAB. REL. REV. 827, 827 (1995) (noting that "vituperative denunciations by critics of [Card and Krueger's] findings" have appeared in a wide range of publications). For additional critiques of the research in *Myth and Measurement* (not included in the 1995 *Industrial and Labor Relations Review* publication), see David Neumark & William Wascher, *Employment Effects of Minimum and Subminimum Wages: Reply to Card, Katz, and Krueger*, 47 INDUS. & LAB. REL. REV. 497 (1994); David Neumark & William Wascher, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Comment*, 90 AM. ECON. REV. 1362 (2000); Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405 (1997).

17. However, if one were to develop a strong theory explaining why minimum wage laws do not decrease employment, the theory would probably undermine the validity of the analysis taken in this Article. *See* Donohue, *supra* note 3, at 911 (making a similar comment regarding Jolls's analysis).

II. THE BASIC FRAMEWORK

FIGURE 1
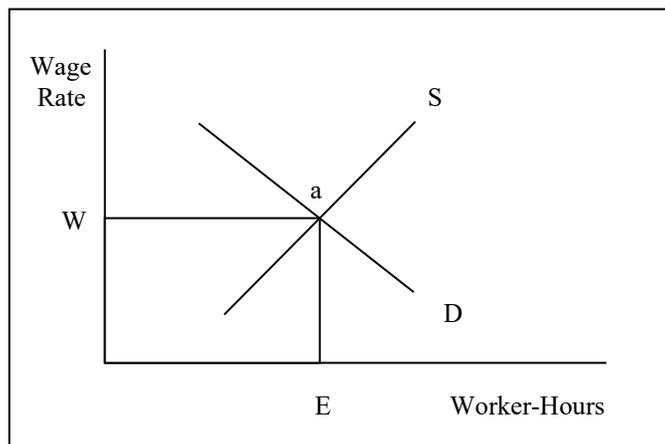
Wage rates are reflected on the vertical axis and worker-hours are reflected on the horizontal axis of Figure 1. Because this Article uses a partial equilibrium analysis, as did Summers and Jolls, other factors affecting demand and supply, such as product demand schedule, capital and technologies availability, and wages in other labor markets, are held constant. On the demand side, *D* represents employers; on the supply side, *S* represents employees and potential employees.[18]

The demand curve represents employers' demand for worker-hours at different wage levels. The curve slopes downward, indicating that as wages rise, employers demand less labor. This is because employers are willing to hire additional worker-hours as long as the additional income from the extra hour exceeds the wages and other costs associated with hiring the extra hour of labor, and that additional labor, at fixed rates of capital, yields diminishing returns. Labor yields diminishing returns because each additional worker has less capital and technologies with which to work and because the each worker is performing less critical tasks, as

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18. The curves are drawn as lines for ease of illustration.

previously hired worker-hours already performed the more critical tasks.

The supply curve represents the employees' willingness to work at different wage levels. The curve slopes upward, indicating that as wages rise, employees and potential employees are willing to offer more worker-hours.[19] Point *a*, at which the *S* and *D* curves intersect, is the market clearing wage. At this point, the wage is *W* and the number of worker-hours provided is *E*.[20]

Because providing benefits is costly, the enactment of a mandated benefit will increase employers' wage costs.[21] A general equilibrium analysis portrays a shift of part of the incremental costs to consumers, in the form of increased prices of products or services, and to employers, in the form of reduced profits.[22] A partial equilibrium analysis depicts only a shift to the employees themselves, who pay for the mandated benefits they receive either with nominal wage reductions or with decreases in previously provided fringe benefits, such as free uniforms and transportation, employer contributions to pension plans, or free food.[23]

Because of wage rigidities,[24] the shift of costs from employers to

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19. This is somewhat simplified; in certain parts, the supply curve might be backward-bending, signifying that a rise in the wage rate will cause a decrease in employment. This is due to the dominance of the income effect over the substitution effect. The income effect results because leisure is a normal good. The more income one has, the more leisure one wants to consume. The substitution effect results because leisure becomes more expensive as the wage rate increases. The price of leisure is its opportunity cost—the wage that could be earned if not for the consumption of leisure—which equals the wage rate times hours of work. An upward sloping supply curve assumes that the substitution effect dominates the income effect—due to the wage rate increase, leisure becomes more expensive, so employees consume less of it.

20. For a more detailed description, see RONALD G. EHRENBERG & ROBERT S. SMITH, MODERN LABOR ECONOMICS 37–48 (7th ed. 2000); John J. Donohue III, *Is Title VII Efficient?*, 134 U. PA. L. REV. 1411, 1412–15 (1986).

21. Julie A. Roin, *United They Stand, Divided They Fall: Public Choice Theory and the Tax Code*, 74 CORNELL L. REV. 62, 89 n.146 (1988) ("Even those fringe benefits which [are defined for tax purposes as] a 'no-additional-cost-service' (and which are, therefore, excluded from income under [I.R.C.] section 132(a)) are costless only when viewed from the narrowest possible perspective.").

22. Such shifts are likely to be small, possibly negligible, at present competitive markets.

23. Assume, for example, that a preexisting compensation package is comprised of $20 per hour in monetary wage and $3 per worker-hour in fringe benefits. If a mandated benefit that costs the employer $2 per hour is enacted, the employer may shift the cost of the mandated benefit to the employees by decreasing either the monetary wage or the level of the fringe benefits.

24. These include minimum wage laws, collective bargaining agreements that restrict the employer's ability to lower wages, and workplace norms and strategy. *See generally* TRUMAN F. BEWLEY, WHY WAGES DON'T FALL DURING A RECESSION (1999). The general theme of Bewley's book, which is based on interviews with executives, is that employers are averse to cutting wages for fear of hurting employees' morale, which they feel is critical in gaining the cooperation of their employees and in convincing their employees to internalize the managers' objectives for the company. *Id*.

employees may not take place in the short run. But in the long run, employers will be able to shift the cost to employees by not raising their wages and by offering lower fringe benefits.[25] If such decreases do not take place, because of a relative elasticity of the supply curve or because of minimum wage laws, employees will suffer the consequences of a decrease in demand for worker-hours—underemployment[26] or unemployment. Unemployment reduces the profits of employers as well, but this does not mean that it improves the welfare of any of the employees. Efficient economic transactions are win-win situations; therefore, the fact that a mandated benefit reduces employers' welfare does not mean that the benefit aids employees.[27]

FIGURE 2

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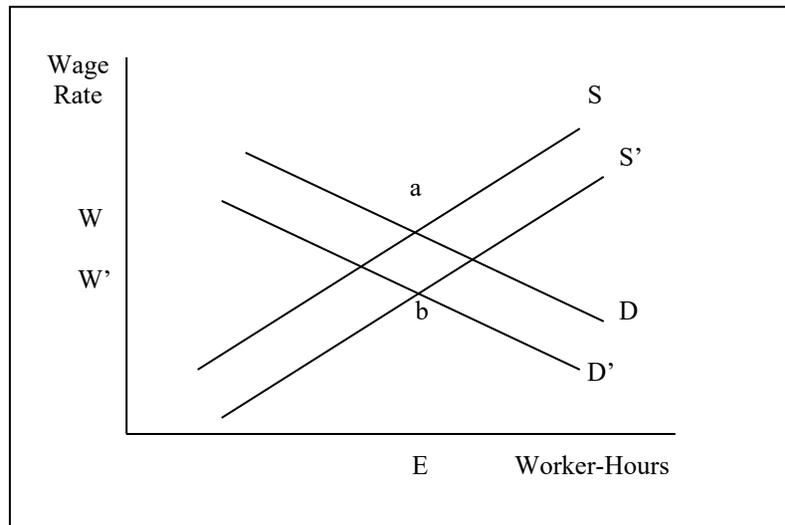
    25. The standard economic assumption, which is based on theory as well as empirical studies, is that in the long run employees pay for the benefits they receive. *See* EHRENBERG & SMITH, *supra* note 20, at 74–76; HAMERMESH, *supra* note 13, at 45–56; David J. Brailer & R. Lawrence Van Horn, *Health and the Welfare of U.S. Business*, 71 HARV. BUS. REV. 125, 125–28 (1993); Gruber & Krueger, *supra* note 12, at 112–39.
    26. In this context, underemployment can be defined as situations in which employees work fewer hours than they desire.
    27. *See* discussion *infra* Part V.

As previously mentioned, employers will hire employees up to the point at which the employees' wages and other associated costs, such as mandated benefits, equal their marginal revenue product of labor. Because higher compensation packages (wages plus benefits) are due to the mandated benefits at any given employment rate, no movement along the demand curve takes place. Instead, the demand curve itself shifts down to the left; D' is the new demand curve. The vertical distance between curves D and D' is the mandated benefit's cost to the employer.

Employees usually place some value on the benefit that they are mandated to receive. They will be willing to accept less in wages as long as the value they place on their total compensation package (wages plus benefits) does not decrease. Because this holds true for employees at any given employment rate, no movement along the supply curve takes place. Instead, the supply curve itself shifts down to the right; S' is the new supply curve. The vertical distance between curves S and S' is the mandated benefit's value as assessed by the employees.

The value that employees put on the benefit can be greater than, equal to, or smaller than the benefit's cost to the employer. If the value equals the cost, there are no real wage or employment effects. This is the situation depicted by Figure 2. The employees receive a different combination of compensation package, which has an equivalent value. Employees appreciate the benefits their employers are mandated to supply and are indifferent to whether they receive the benefits or cash wages in an amount representing the value they place on the benefits. This, of course, is a reasonable assumption, as it follows from the meaning of "value." Saying that employees place a certain value on the benefits they receive means that they are willing to pay this specific amount to purchase them and that giving up a cash wage is equivalent to paying cash.[28] Employers bear the same labor costs as they did prior to the enactment of the mandated benefits, and because employment level is a function of the wage rate, employment remains constant. It is as if nothing has happened.

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28. This statement ignores any possible psychological differences, such as the endowment effect (also known as the framing effect), according to which people tend to place higher values on things that they own relative to what they would have been willing to pay for the same things if they did not own them. *See*, *e.g.*, Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1326–28 (1990); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 279 (1979). These differences do not change the analysis here because to the extent the differences affect employees (i.e., employees find it difficult to give up some of their cash wage) they will simply be reflected in lower values that employees place on the benefits, compared to the value the employees otherwise would have placed on them.

A. *Value Is Lower than Cost*

FIGURE 3
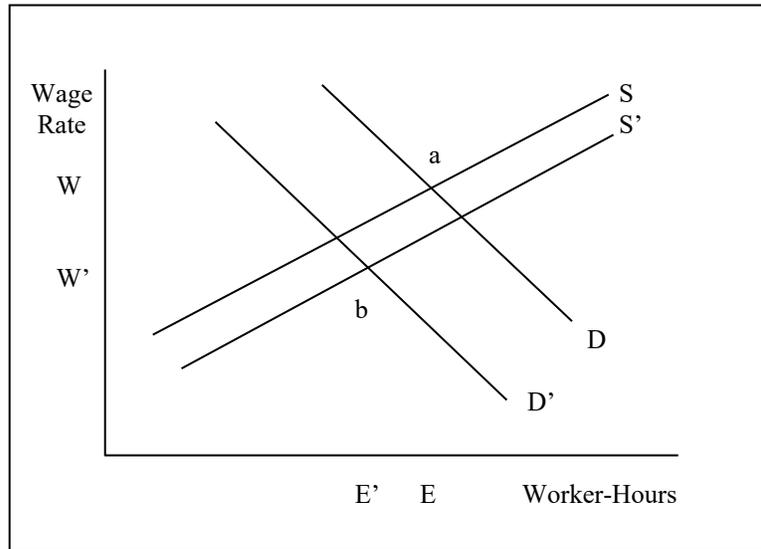
Figure 3 is similar to the figure that Summers used to present his model.[29] The figure depicts a mandated benefit that has a greater cost to employers than value to employees. This can be seen by the difference in vertical distances between the demand curves and supply curves. The employees are willing to cut their wages by a small amount because of the value they place on the mandated benefits, but the employers are demanding a greater cut in wages, reflecting their greater cost incurred in supplying the benefits. This leads to changes in wage and employment rates. Point *b*, at which the *S'* and *D'* curves intersect, is the new market clearing wage. At this point, the wage is *W'* and the number of worker-hours provided is *E'*.

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29.   *See* Summers, *supra* note 4, at 180.

The net cost of the mandated benefit is the difference between the value that the employees place on the benefit and the cost to the employers of providing the benefit. This causes a decline in the wage rate from *W* to *W'* and a decrease in employment level from *E* to *E'*.

A simple way to understand and demonstrate the effect the mandated benefit has on the wage rate and employment level in such a case is to *net* the movements of the curves. Both curves shifted down, but the demand curve shifted down farther. We can therefore draw a figure, such as Figure 4, that illustrates only the relevant change—the net cost of the mandated benefit.

FIGURE 4
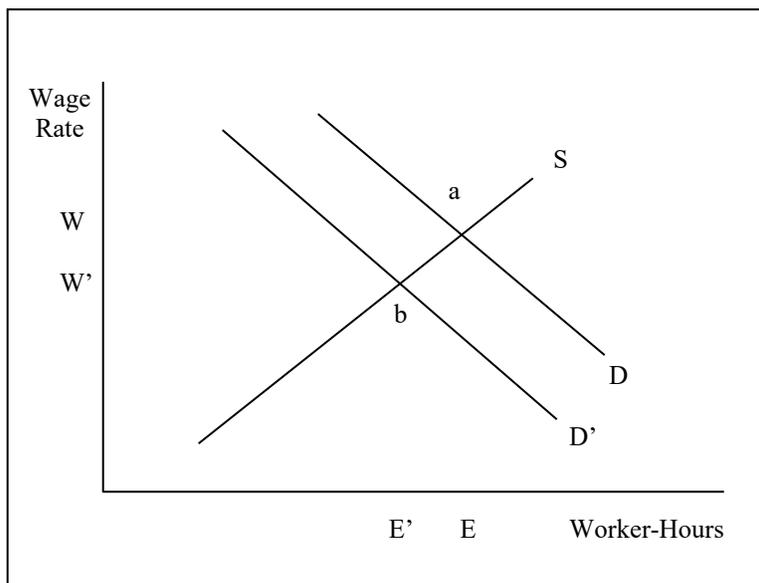
Assume, for example, that a preexisting compensation package is comprised of $20 per hour and that a mandated benefit, which costs the employer $3 per hour per employee and is valued by each employee at $1 per hour, is enacted. The supply curve would shift down by $1, and the demand curve would shift down by $3. The result is a net shift down of the demand curve by $2. Because the employees value the benefit that the employer is mandated to provide to them at $1, the employer has to pay them $19 in cash in order to maintain the same wage rate that prevailed prior to the enactment of the mandated benefit. But the cost to the employer is now $22 because it costs the employer $3 to provide the

benefit. Therefore, the employer demands fewer worker-hours. Because this is true for every point on the demand curve, there is no movement along the demand curve. Instead, the demand curve itself shifts downward by $2. The equilibrium point is now at the intersection of the supply curve and the new demand curve, which is lower. Thus, the employees bear part of the net cost of the mandated benefit (the difference between the value to employees and the cost to employers) in the form of lower wages and lower employment levels.

B. How Is the Burden Being Shared Between Employers and Employees?

When the labor supply is relatively inelastic, the wage rate decreases by the full cost of the mandate, even though the value the employees place on the mandate is lower than the cost to the employer. In this "inelastic supply case," only employees bear the burden. To the degree that employees' wages do not fall, the employment level will—"the elastic supply case." This makes employers worse off as well; the greater cost of labor forces them to decrease their demand for labor and they have to decrease their output. Prior to the enactment of the mandated benefit, they made a profit on that additional output. Hence, the decrease in output reduces their profit.

However, employees as a group are not necessarily better off than they were in the inelastic supply case, in which wages fell by the full cost of the mandate, because some employees lost their jobs. Those employees who kept their jobs are better off in the elastic supply case compared to the inelastic supply case, in which all employees' wages decreased by the full cost. For the employees who lost their jobs, the loss of welfare may be greater than the aggregate decrease in loss experienced by the employees who maintained their jobs. Thus, the overall welfare loss in the elastic supply case may be equal, smaller, or larger than the welfare loss in the inelastic supply case.

Assume, as in the example above, that the wage rate is $20 per hour and that a mandated benefit is enacted. The mandated benefit has a value of $1 per hour to each employee and a cost of $3 per hour per worker to the employer. In the inelastic supply case, the employees bear the full cost of the mandate. Therefore, the wage rate decreases to $17 per hour, and the value of the compensation package after the mandate is enacted is only $18 per hour. Under the elastic supply case, the wage rate only decreases to $18, and the value of the compensation package

after the mandate is $19 per hour. Because the labor cost has increased, labor demand has declined. Assuming that half of the employees are laid off, it is not clear which case produces a greater welfare for the employees as a group: (1) the inelastic supply case, in which only the employees bear the burden and all of them share equally in it, or (2) the elastic supply case, in which the employer and the employees share in the burden, but some employees lose their jobs and the rest of the employees bear a smaller burden compared to their share of the burden in the inelastic supply case.

The degree to which wage rates will decrease depends on the relative elasticities of supply and demand for labor. Elasticity is the percentage change in employment induced by a one percent increase in the wage rate. As mentioned above, the demand curve slopes downward. Therefore, an increase in the wage rate will cause employment to decrease. If a one percent increase in the wage rate causes a one percent decrease in demand for labor, the wage elasticity of demand is said to be unitary. If the change in employment level is greater than one percent, the demand curve is considered to be relatively elastic; if the change is less than one percent, the demand curve is said to be relatively inelastic. The flatter the demand curve, the more elastic it is.[30]

On the supply side, things may be a little more complicated because the curve does not necessarily slope upward.[31] When it slopes upward, indicating that as wages rise, employees and potential employees are willing to offer more worker-hours, elasticity can be defined as follows: If a one percent increase in the wage rate causes a one percent increase in supply of labor, the wage elasticity of supply is said to be unitary. If the change in employment level is greater than one percent, the supply curve is considered to be relatively elastic; if the change is less than one percent, the supply curve is said to be relatively inelastic. The flatter the supply curve, the more elastic it is.

If the labor market supply curve were perfectly inelastic—vertical—the entire cost ($2 in our example) would be shifted to the employees in the form of lower wages. The employment level would not change. This is depicted by Figure 5.

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30. Elasticity changes along the curve when the curve is drawn as a straight line. As it goes down, it becomes less elastic. In the section of the curve where wages are high and labor demanded is low, a one percent decrease in the wage rate would increase the employment level by a relatively large percentage. At a point further down the curve, a one percent decrease in the wage rate would increase employment by a smaller percentage because the same increase in the number of labor units would represent a smaller percentage of total employment, compared to the part of the curve that represents high wage rates and little employment.

31. It slopes backward when the income effect dominates the substitution effect. *See* discussion *supra* note 19.

FIGURE 5
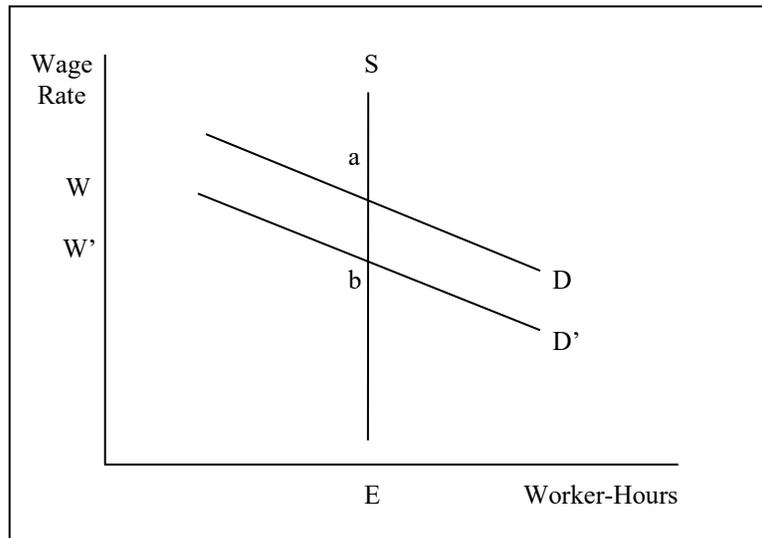
If, on the other hand, the labor supply curve were perfectly elastic—horizontal—wages would not fall at all, but employment would. This is depicted by Figure 6.

FIGURE 6
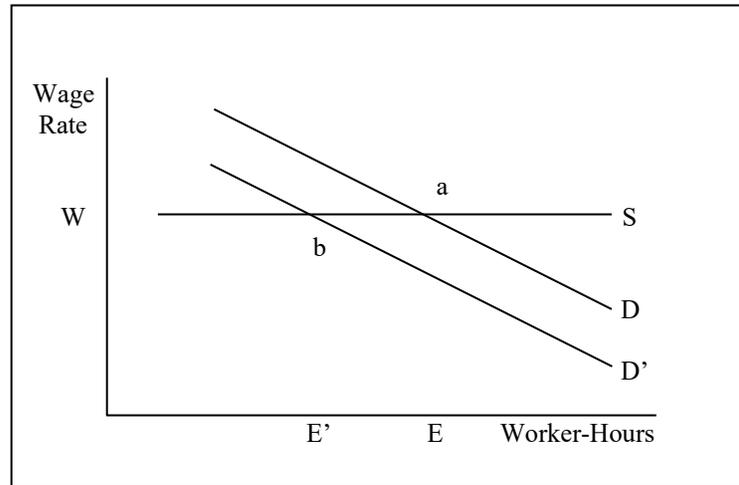
The elasticity of the demand curve has mirror effects. If the demand curve were inelastic—vertical—there would be a large change in the wage rate but a small change in the employment level. And if the demand curve were elastic—horizontal—there would be a small change in the wage rate but a large change in the employment level.

The outcome is determined by the *relative* elasticities of the supply and demand curves for labor. It can also be more simply described by comparing the slopes of the supply and demand curves.[32] As mentioned above, most labor economists maintain that the labor supply is relatively inelastic. Therefore, most of the cost of a mandated benefit is borne by employees in the form of a reduced wage rate without a substantial employment decrease.

C. Value Is Greater than Cost

When employees place a value on a benefit that is greater than the employer's cost of providing the benefit, there is a net gain. Assume, for example, that a preexisting compensation package is comprised of $20 per hour and the enactment of a mandated benefit that is valued by each employee at $3 per hour and costs the employer only $1 per hour per

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32. Philip E. Graves et al., *Slope Versus Elasticity and the Burden of Taxation*, 27 J. ECON. EDUC. 229, 232 (1996).

employee. The supply curve would shift down by $3, and the demand curve would shift down by $1. The result is a net shift down of the supply curve by $2. The new equilibrium point, depicted by Figure 7, is at a higher employment level.

FIGURE 7
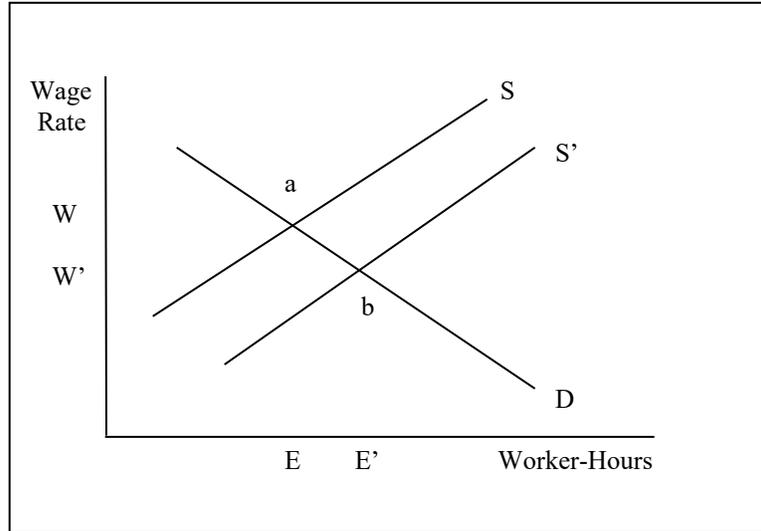
If the supply curve indeed shifts down by the full value that the employees place on the benefits, employees do not share in the surplus by way of receiving a higher compensation package.[33] Their wages decrease by the full value of the benefit, not only by the cost to the employer of providing the benefit. Because demand for worker-hours increases, employees gain as a group. Overall, employees' welfare surplus increases, but the compensation packages of individual employees do not.

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33. A general equilibrium analysis would show that, in the long run, wages may rise due to shortages in the labor supply and relative decreases in the cost of labor compared to capital—the substitution effect.

III. What Does the Term "Efficiency" Mean in the Context of Mandated Benefits?

A. When the Employment Level Does Not Decrease

Economists often view only those mandated benefits that result in lower employment levels as inefficient.[34] This Part will try to see the limits of this level-of-employment test as a guide for efficiency.

The test clearly does not apply to a decrease in the wage rate that is greater than the value that existing employees place on the benefit; in other words, the decrease is an outcome of the relative inelasticity of labor supply. The mandated benefit is as inefficient as a mandated benefit that results in unemployment. Employees' welfare is reduced by the mandate, and no one else in society benefits from it.[35]

Using the previous example to demonstrate the argument, assume the existence of a mandated benefit that costs the employer $3 and is valued by the employees at only $1. The labor supply curve should go down by $1 and the labor demand curve should go down by $3. There should be a net downward shift of the demand curve by $2. If one assumes a perfectly inelastic labor supply, the employment level does not change at all. This may look like the outcome of an efficient mandated benefit. In other words, it may look like a mandated benefit that costs the employer $2 and is valued by the employees at $2. But the employees value the mandated benefit by $2 less than its cost. Therefore, relying on the change in employment level as a means of assessing the efficiency of mandated benefits is not accurate when the employment level decreases.

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34. *See, e.g.*, Krueger, *supra* note 13, at 322. The last two sentences of Krueger's article are the following:

> Nevertheless, my calculations of the employment and wage effects of an employment-based health care mandate indicate that the employment loss caused by the mandate would not be great, mainly because workers' labor supply decisions are relatively insensitive to wages. If this is correct, then an employment-based health insurance mandate may not be much more inefficient than other, probably less politically feasible, policies.

Id. Presumably the "other" policies are tax-financed programs. The inefficiencies they cause are identical to the inefficiencies caused by mandated benefits. Assuming an elastic labor supply, tax-financed programs with a tax component greater than the value employees place on the benefits will result in lower employment levels as well. *See* discussion *infra* Part IV.

35. That is the opposite of a Pareto improvement. A Pareto improvement, named after the nineteenth century economist Vilfredo Pareto, is defined as a reallocation of resources that makes at least one person better off without making anyone else worse off. *See* Rosen, *supra* note 15, at 41. Therefore, a reallocation that makes employees worse off without making anyone else better off is inefficient by definition.

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B. Distinguishing Between "Narrow" and "Broad" Definitions of "Efficiency"

When the value that employees place on the benefit is greater than the cost to employers of providing the benefit, the outcome is efficient. In a well functioning labor market, however, such a situation is impossible, and mandated benefits can only *reduce* efficiency. If employers and employees could freely negotiate the terms of the employment contract, they would choose the compensation packages that best suit them.[36] The costs of providing specific benefits differ across employers, and employees differ in tastes. This allows for a *sorting process* to extract maximum utility for employees and profit for employers.[37]

For example, a risk averse employee may prefer a stable job offered by an employer that puts a high value on firm-specific human capital, and in return the employee would settle for a lower wage that would enable the employer to invest in the employee's training.[38] Mandated benefits restrict employers' and employees' freedom of contract and prevent the extraction of gains from the sorting process.[39] Therefore, in a well functioning market, any mandated benefit would involve greater cost to employers than value to employees because the benefit would otherwise have been provided voluntarily.

In reality, the labor market has all kinds of inefficiencies. When a mandated benefit has a net value, there must have been a market inefficiency that prevented employers and employees from voluntarily reaching this welfare enhancing result, and the mandate subsequently overcame this market inefficiency. The result is efficient because the total welfare is greater. Employers and employees are better off because

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36*. See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 363 (5th ed. 1998); Krueger, *supra* note 13, at 298.

37. According to the standard economic assumption, employees are assumed to attempt to maximize their utility, while employers are assumed to attempt to maximize their profit—or, in the case of not-for-profit employers, some measure of services rendered, net of costs. *See* EHRENBERG & SMITH, *supra* note 20, at 63. There are exceptions to this rule, such as where an employer has a taste for discrimination.

38*. See generally* GARY S. BECKER, HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS, WITH SPECIAL REFERENCE TO EDUCATION (2d ed. 1975) (being the first to formalize the distinction between general and job-specific human capital); Michael L. Wachter & Randall D. Wright, *The Economics of Internal Labor Markets*, 29 INDUS. REL. 240 (1990) (explaining that specific human capital is one of the most important factors that create internal labor markets).

39. Krueger, *supra* note 13, at 305–06.

they share in the surplus generated by adding a benefit to the compensation package that has greater value than cost, while no one in society is made worse off. This outcome satisfies the most basic and least demanding definition of efficiency, known as Pareto efficiency.[40]

But even when the value that employees place on the benefit is smaller than the cost to employers of providing the benefit, the outcome may be efficient. This depends on the specific market inefficiency that the mandated benefit was enacted to cure. For example, mandating employers to provide health care insurance to their workers, at a cost that is greater than the value that employees place on it, may still be efficient if the size of the positive externality to society is greater than the net cost borne by employers and employees. The following are a few examples that illustrate the need to analyze the efficiency of mandated benefits according to the underlying market inefficiencies that led to the enactment of the benefits.

1. Free Riding on Collective Goods

Collective goods are benefits that, by their nature, must be supplied to a group of employees if they are supplied to one employee. The cost of preventing employees from enjoying benefits they did not pay for is higher than the amount an employee is required to pay for the benefits. Hence, these benefits are nonexcludable. Health and safety terms often have such nonexcludable nature.

For example, preventing employees who did not share in financing a new air-cleaning machine from deriving benefit from the new technology is much too expensive to be realistic. Therefore, if each individual employee is rational, each has an incentive to conceal her true preference for the collective good and pretend as if she is placing a lower value on the good than its real value to her. By doing so, the employee is trying to make the other employees finance part of her share in the cost of the benefit.

When many employees act in this way, efficient benefits—benefits that employees truly value more than they cost—are not purchased at all. Employees conceal the real value that they place on the benefits, and the employer does not provide the benefit because it believes that the benefit's value is lower than its cost. The employer would have offered

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40. If one relaxes the assumption that all employees have identical preferences, it becomes possible that some employees will put a low value on the benefit and will therefore be made worse off. The mandated benefit may still be considered efficient, not according to the Pareto rule, but according to the Kaldor-Hicks rule, as long as those who gain from the mandated benefit gain enough so that they *could* compensate those who lose, without requiring that such compensation actually be paid. *See* POSNER, *supra* note 36, at 12–17.

the benefit in return for a wage reduction had it known the true value that employees place on the benefit.[41]

   This free riding problem also exists with public goods supplied by the government.[42] Residents and citizens have an incentive to understate the true values they place on the benefits because everyone is supposed to share the financing of the goods according to the value that each individual places on them. The government solves the problem of free riding in public goods by financing them through taxes.[43] This may be an option in the employment context as well. But when the employer supplies the benefits, government intervention takes the form of mandated benefits. Policymakers estimate the aggregate value that employees truly place on the benefits and coerce employees into purchasing the benefits by mandating employers to provide them.[44]

   Mandated benefits that are designed to overcome the inefficiency caused by free riding behavior are efficient even under the narrow definition of efficiency. The benefits provided because of such mandates are meant to have greater value to employees than cost to employers. Of course, there are individual employees who place a lower value on the benefits than the cost of providing the benefits to them. But the mandated benefits should still be considered efficient according to the narrow definition, as long as the efficiencies they created for some employees outweigh the inefficiencies created for other employees. This type of efficiency is known as Kaldor-Hicks efficiency.[45]

2. Imperfect Information

   The employment contract is unique because it may endure for a very long term, possibly throughout the employee's entire life. Moreover, the employee usually offers general efforts, not particular outcomes or specific projects. This makes the contract incomplete, as employers and employees lack information that is relevant to many issues that are most likely to arise during the course of their relationship.[46] Devising ex-ante

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   41.   For a classic example of this matter, see Steven L. Willborn, *Individual Employment Rights and the Standard Economic Objection: Theory and Empiricism*, 67 NEB. L. REV. 101, 120–27 (1988).
   42.   *See* ROSEN, *supra* note 15, at 63.
   43.   *Id*. at 64.
   44.   *See* Krueger, *supra* note 13, at 297.
   45.   *See* discussion *supra* note 40.
   46.   Samuel A. Rea, Jr., *Workmen's Compensation and Occupational Safety Under Imperfect Information*, 71 AM. ECON. REV. 80, 80 (1981); Gregory K. Dow, *The New*

procedures and terms that will help solve some of these issues is costly, and the parties usually do not write comprehensive ex-ante covenants.[47] Moreover, changes in the law, whether by legislation or court decisions, affect the employment contract in a manner that is usually too comprehensive and complex to be negotiated anew for each employment situation. Accordingly, because they have imperfect information, employees usually do not bargain for particular benefits that they should objectively desire.[48]

In addition to the difficulties associated with obtaining such information, employees may suffer from systematic misinformation provided by employers regarding certain facts, such as the risks involved in the job and psychological barriers.[49] Employees may, for instance, underestimate the benefit of purchasing—by way of accepting a wage reduction—a new safety device because they have difficulties admitting how risky their jobs really are or admitting that they made mistakes taking the jobs in the first place.[50] Empirical studies have found that individuals often act irrationally, systematically misjudging probabilities and insuring themselves inadequately.[51] For example, they tend to overinsure against predictable, small losses and underinsure against unpredictable, catastrophic losses.[52]

The issue of irrationality is related to another reason behind government intervention—paternalism. Society may believe that individuals value certain services too little. For example, employees generally tend to underestimate the importance of pension savings or merit goods, such as education or health insurance.[53]

Institutional Economics and Employment Regulation, in GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 57, 57–59 (Bruce E. Kaufman ed., 1997).

47.   Dow, *supra* note 46, at 57–59.

48.   For example, employees mistakenly tend to believe that the law provides them much greater protection against discharges than in fact it does. Therefore, they fail to contract for efficient "for cause" provisions in return for part of their wages or other benefits. *See* Willborn, *supra* note 41, at 128.

49.   *See* Kahneman & Tversky, *supra* note 28, at 274–87 (finding that individuals systematically err by preferring outcomes that are obtained with certainty to equally preferred outcomes that are merely probable); *see also* Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1476–79 (1998). *See generally* Mark Kelman et al., *Context-Dependence in Legal Decision Making*, 25 J. LEGAL STUD. 287, 287 (1996) ("A person who prefers chicken over pasta should not change this preference on learning that fish is also available."); Amos Tversky & Itamar Simonson, *Context-Dependent Preferences*, 39 MGMT. SCI. 1179 (1993) (noting that people's choices are irrationally affected by the order in which the options are presented to them).

50.   *See* SAMUEL ESTREICHER & STEWART J. SCHWAB, FOUNDATIONS OF LABOR AND EMPLOYMENT LAW 207 (2000).

51.   *See generally* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman et al. eds., 1982).

52.   ESTREICHER & SCHWAB, *supra* note 50, at 206.

53.   *See* MUSGRAVE, *supra* note 5, at 13–14 (defining *merit wants* as public wants

When parties lack information and the government intervention reveals the information, such as in the case of provisions of the Employment Retirement Income Security Act of 1974 (ERISA)[54] that impose disclosure requirements regarding pension plans on employers, the outcome will be efficient under the narrow definition of efficiency. Usually, however, the government intervention does not require that employers reveal information; it simply forces the parties to add terms to the employment contracts that they failed to negotiate due to the lack of information. Because the parties remain ignorant after the government intervention, the values they place on the mandated benefits are too low. This means that the mandated benefits are inefficient under the narrow definition of efficiency. However, assuming that the government accurately assessed the situation, the mandated benefits are still efficient under the broad definition of efficiency.

3. Externalities

An externality is the effect of one entity on the welfare of another in a way that is not transmitted by market prices.[55] Externalities can be positive or negative.[56] When an externality is negative, such as factory pollution, government intervention may be helpful because transaction costs or a lack of defined property rights may bar the parties from reaching an efficient contract—the Coase Theorem.[57] An example of helpful government intervention in this case would be the government's making the polluting factory bear the costs of pollution.

In the context of the employment contract, for example, layoffs at one firm may raise unemployment insurance taxes—premiums—at other firms. This would justify government intervention in the form of mandatory plant closing notification.[58] Externalities can be positive, and government intervention may be required to guarantee a high level of such a beneficial activity.[59] A good example of such a positive

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considered "so meritorious that their satisfaction is provided for through the public budget, over and above what is provided for through the market and paid for by private buyers" and stating that "situations may arise, within the context of a democratic community, where an informed group is justified in imposing its decision upon others").

54. 29 U.S.C. §§ 1001–1461 (2002).
55. ROSEN, *supra* note 15, at 79–81.
56. *Id.*
57. *See generally* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).
58. *See* Summers, *supra* note 4, at 178.
59. ROSEN, *supra* note 15, at 100.

externality is employer provided health care. Society is unwilling to deny health care benefits to poor, uninsured individuals when they become seriously ill. The mandated benefit therefore creates a positive, altruistic externality.[60]

Mandated benefits that were enacted to overcome externalities, whether negative or positive, are never efficient under the narrow definition of efficiency. These mandated benefits confer benefits on third parties; therefore, their value to employees is lower than the cost to employers to supply them. They are efficient according to the broad definition of efficiency only because the welfare of third parties is taken into account.

4. Adverse Selection

Private markets for certain kinds of insurance may fail to emerge because of information asymmetry.[61] Employers offering certain insurance pitched for the average person will attract a disproportionate share of employees that are likely to overuse such a policy. Summers gives the example of an employer offering health insurance to employees, financing the insurance premium with a salary reduction equal to the average cost of insurance.[62] Employees who expect to underutilize the benefit will tend to go elsewhere, while employees who expect to use the benefit extensively will be attracted to that workplace. This will raise the costs to the firm of providing the benefit and require the firm to further lower the monetary wages. This will cause moderate users to drop out, which will raise the cost still higher. This may ultimately result in the benefit not being offered at all, even if the average and total cost of providing the benefit is lower than the average and total utility that employees would derive from that benefit.

Asymmetric information between employers and employees regarding the safety of the workplace, the likelihood of taking parental leave, and

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60. *See* Summers, *supra* note 4, at 178; *see also* Marianne A. Ferber, *Commentary on Chapter 5*, *in* GENDER AND FAMILY ISSUES IN THE WORKPLACE 162, 162 (Francine D. Blau & Ronald G. Ehrenberg eds., 1997).

> Parental leaves are useful because according to most experts in the field, children will do better when cared for in their own home at least for some months after they are born. This in turn is good for employers and for society in the long run, because children who get a better start are more likely to grow up to be productive workers and good citizens.

Id.

61. For more on information asymmetry, see George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970); Michael Rothschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q.J. ECON. 629 (1976).

62. *See* Summers, *supra* note 4, at 178–79.

so forth, may cause similar problems. Mandated benefits are applied to all of the employers; therefore, the bad risks do not flock to the one firm that offers them. If the benefit is desirable from a policy perspective, then the mandated benefit will have a positive outcome.[63]

Mandated benefits that were enacted to overcome adverse selection inefficiency may be valued by the employees at or above their cost and may therefore be efficient according to the narrow definition of efficiency. They may not be efficient for a particular employee who places a low value on the benefits or for a particular employer if the benefits are relatively more costly for it to provide, but the mandated benefit may be efficient overall.

5. Transaction Costs

As mentioned above, the employment contract is a unique type of contract that is bound to be incomplete.[64] At the time it is negotiated, the parties cannot anticipate all future contingencies and enforcement may require extensive monitoring. In addition, employees may feel uncomfortable asking for certain benefits, such as sick leave or severance pay, for fear of making bad impressions on their employers. Employees will usually value a mandated benefit that overcomes this type of market inefficiency, and its efficiency can therefore be evaluated under the narrow definition of efficiency.

C. Implementing the Accurate Definition of "Efficiency" in the Context of Mandated Benefits

This Article's first point deals with a "narrow" definition of efficiency; the second point deals with a "broad" definition of efficiency. According to the narrow definition of efficiency, which is consistent with Pareto efficiency, a mandated benefit is efficient as long as employees place a value on it that is higher than its cost of provision to employers. As previously mentioned, this is a direct implementation of the Pareto principle.

The broad definition of efficiency is more complicated. It applies to cases in which the value that employees place on the benefit is lower than the cost that employers incur in providing the benefit. Such cases

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63. Krueger, *supra* note 13, at 300.
64. *See supra* note 46 and accompanying text.

are inefficient according to the narrow definition of efficiency. But the narrow definition of efficiency may, in fact, be circular. It assumes that the value that employees place on the benefits is accurate because it is the outcome of the free market. In the free market, prices are usually relied on as a means of directing resources to their highest valuable uses. But, in the context of mandated benefits, one ought to remember that the reason the benefits were enacted in the first place was the existence of certain market failures. In such cases, how can the value and price mechanism be relied on to lead to an efficient result if the baseline assumption is one of market failure?[65]

IV. MANDATED BENEFITS VERSUS TAX-FINANCED PROGRAMS

There are four different means by which the government can intervene in the provision of goods to workers. The first option is a general resources financed program. The government can allocate a portion of the national budget toward financing and providing benefits to all citizens or to working residents. If one focuses on the marginal increase in public spending, then this option is actually a tax-financed program because all previous resources have already been allocated. The tax that is used to finance the program can be any kind of tax; for example, it could take the form of a proportionate increase in all existing taxes. The second option is a limited case of the first option: financing the benefits by a payroll tax.[66] Under this option, employees pay the government for the benefits they receive. The government's third option is to induce employers to offer, and employees to accept, certain benefits by way of allowing a tax or other kind of subsidy.[67] The fourth option is mandating employers to provide certain benefits to their employees.

It is most likely that when Summers compared mandated benefits and tax-financed programs, he was referring to payroll or income taxes; in his examples, it is assumed that all employers and employees paid the tax that financed the benefits. Likewise, this Part compares a benefit program financed by a tax on labor income with a mandated benefits program. The general theory is applicable to the other options as well.[68]

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65. For a similar criticism of the new institutional economics, see Dow, *supra* note 46, at 60.

66. An example would be Social Security.

67. For a discussion of the equivalence of a tax subsidy and a direct grant, see STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1983); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES (1973).

68. *See* MARK KELMAN, STRATEGY OR PRINCIPLE? THE CHOICE BETWEEN REGULATION AND TAXATION 125 (1999) (noting that from a constitutional point of view, as courts have interpreted it, there is no distinction between mandated benefits—regulation—and tax-financed programs).

A. *Excess Burden (Deadweight Loss)*

1. *What Is Excess Burden?*[69]

Summers claimed that tax-financed programs usually entail greater excess burden than mandated benefits.[70]   In the context of taxes, inefficiency is usually referred to as *excess burden* or *deadweight loss*.[71] It is a loss of welfare above and beyond the tax revenues collected.[72]   In other words, it is a net welfare loss. It is caused by reducing the welfare of taxpayers by taxing them without generating revenue that could be used to enhance welfare through government actions, such as provision of public goods or redistribution, if justified under society's social welfare function.[73]

A significant part of the inefficiency cost of taxation is attributable to administrative costs such as compliance and enforcement.[74]   Moreover, some inefficiency is caused by tax avoidance activity because taxpayers engage in transactions that are not optimal from a business perspective and therefore do not generate the highest possible yield. Instead, the taxpayers reduce the taxes that they are required to pay, increasing their after-tax income.[75]   This is a cost to society because the production factors are not optimally used to produce the maximum yield. But the

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69.   Readers who are familiar with the concept of excess burden are advised to skip to Part IV.A.2.

70.   *See* Summers, *supra* note 4, at 179–81.

71.   *See* ROSEN, *supra* note 15, at 282–305; JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 522–26 (3d ed. 2000); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1650–56 (1999).

72.   *See* ROSEN, *supra* note 15, at 283.

73.   For example, utilitarians require redistribution from wealthy to poor individuals. Under standard assumptions that all individuals have similar utility functions and that income, like all other normal goods, has a declining marginal utility, then subject to efficiency limitations, such redistribution will increase the aggregate utility—maximizing the utilitarian social welfare function. *See generally* Francis Bator, *The Simple Analytics of Welfare Maximization*, 47 AM. ECON. REV. 22 (1957).

74.   JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE GREAT DEBATE OVER TAX REFORM 130–33 (1996).

75.   This may include the substitution of untaxed fringe benefits and more pleasant working conditions for taxable income; a shift in portfolios to tax-deferred forms, such as IRAs and section 401(k) pension plans; a migration of businesses from corporate to pass-through entities or vice versa, depending on the difference between individual and corporate income tax rates; and the purchase of owner-occupied housing, home office equipment, and other otherwise unnecessarily preferred expenses, as long as they can be deducted from taxable income and are valued at least at $(1\text{-}t)$—t being the individual's marginal tax rate.

term *excess burden* is often used to describe one specific cost of taxation—the effect that taxes have on relative prices.[76] In the context of this Article, the term refers to the effect that taxes have on the motivation to work.

A wage tax, such as an income tax or a payroll tax, affects the relative price of leisure.[77] The cost of leisure is its opportunity cost, namely, the wage that could have been earned if not for the consumption of leisure. The tax lowers wages and thus makes leisure relatively cheaper. Therefore, people tend to consume more of it and work less. This is commonly referred to as the "substitution effect."[78]   There is an offsetting effect that is due to the loss of income incurred by the tax. People may want to work more in order to maintain their former after-tax income. This is commonly referred to as the "income effect."[79] Only the change in relative prices—the substitution effect—is causing the excess burden. This change introduces a tax wedge between what the employers pay and what the employees receive.[80] The employer pays a before-tax wage of w, but the employee bases her decision regarding whether to work on her after-tax wage, which is $(1 - t)w$, t being her marginal tax rate.

Efficiency requires that the rate at which work transforms leisure into other consumption goods (the marginal rate of transformation, which is actually the incremental production cost of one more unit of output) equal the rate at which employees substitute work for leisure (the marginal rate of substitution).[81] The tax fractures this equality because the marginal rate of substitution is based on the after-tax wage, while the marginal rate of transformation is based on the before-tax wage.[82] Even if employees do not change their labor supply as a result of the tax—a phenomenon that will occur if the income effect offsets the substitution effect—the tax will involve excess burden.

This outcome can be proved by hypothetically replacing the wage tax with a lump sum tax that generates the same amount of revenue. A lump sum tax is a certain amount, such as a head tax of an exact dollar amount, that must be paid regardless of the taxpayer's behavior. It is considered a hypothetical tax because its highly regressive nature makes it politically unfeasible—unless it is tied to characteristics of ability

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76.   *See, e.g.*, ROSEN, *supra* note 15, at 283–97.
77.   Other taxes, such as income taxation of interest, dividends, and capital gains or estate and gift taxation, may affect savings.
78.   *See* ROSEN, *supra* note 15, at 283–97.
79.   *Id*.
80.   *Id*.
81.   *Id*.
82.   *Id*.

other than income—but it is often used as a benchmark for efficiency analysis.[83] Lump sum taxation is unique in that it causes an income effect, but, because it does not change relative prices, no substitution effect.[84]

In the context of this discussion, the lump sum tax does not change the relative cost of leisure because it is not imposed on wages. Individuals must pay it whether they work or not. Such a tax will raise the same amount of revenue while maintaining the taxpayers on a higher utility level than where a wage tax places them, even if the wage tax does not cause a change in the labor supply, as the income and substitution effects offset each other. Hence, comparing the wage tax with this benchmark of a nondistorting tax proves the inefficiency of the wage tax even when there is no change in the labor supply.[85]

2. Tax-Financed Programs and Mandated Benefits Entail the Same Type of Excess Burden

The conventional definition of *excess burden* in the taxation context assumes that the tax is a *net loss* to the taxpayer who pays it.[86] The taxes are not offset by the benefits that the taxpayer receives from the government—benefits that were financed by the tax revenue. This is accurate because the government uses the revenue to finance *nonexcludable* benefits. In other words, the tax has a substitution effect—leisure becomes less expensive—even when the government uses the revenue to the benefit of the taxpayer because the taxpayer receives government provided goods and services whether or not he pays the tax. The government uses the revenue to finance public goods, such as national defense, the court system, and infrastructures, from which every resident can benefit. Public goods are nonexcludable. Other publicly provided goods, such as education, could be excluded, but they are considered to be merit goods—goods that the government would like every resident or citizen to have.[87] Therefore, the tax that individuals pay is viewed as a net loss from each individual's personal perspective.

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83. *Id.*
84. *Id.*
85. For an explanation of this result, see ROSEN, *supra* note 15, at 289–90; STIGLITZ, *supra* note 71, at 536. To fully comprehend the thesis presented in this Article, a general understanding of the term "excess burden" will suffice.
86. ROSEN, *supra* note 15, at 283–97.
87. *See supra* note 53.

In contrast, the tax element in tax-financed programs must be offset against the very benefits that the tax finances because only taxpayers are entitled to the benefits. A payroll tax therefore finances benefits that are paid only to employees. In reality, a payroll tax often finances benefits that accrue to nonemployees. In such a case, the payroll tax should be replaced with a general income tax to more equally spread the burden of financing the benefits on all the taxpayers—specifically, on those who are self employed, if they are not covered by the payroll tax—and on income from capital such as interest, dividends, royalties, rents, and capital gains.

In the example provided here, one would assume that the benefits are confined to employees; therefore, a tax-financed program and a mandated benefit would be the relevant alternatives. When employees pay the payroll tax, their welfare is reduced by the tax but is increased by the benefits they receive from the government that are financed by the revenue generated from the tax. Therefore, when measuring the excess burden of taxes that are part of a tax-financed program—taxes that finance *excludable* benefits—only the *net tax* generates excess burden. The net tax is the tax minus the value of benefits provided by the government to the taxpayer in lieu of the taxes the taxpayer paid, assuming that the value of the benefits is lower than the taxes paid. This is an exact analogy to mandated benefits. The tax is the equivalent of the cost incurred by the employer in providing the benefit.

As demonstrated above, it does not matter whether the employer or the employee formally bears the burden of paying the tax or providing the benefit. If the cost of providing the benefit, or the tax that finances the benefit, is greater than the value of the benefit, the net cost will be borne by the parties according to the relative supply and demand for labor. It will take the form of lower wages or employment level, possibly both. If there is a net gain, the parties will split it accordingly. If the cost and the value of the benefit are exactly the same, nothing will happen. In the case of mandated benefits, wages will decrease, but the value of the total compensation package (wages plus benefits) will remain the same. In the case of a tax-financed program, the after-tax value of the compensation package will remain the same: a smaller monetary wage, but an additional benefit.

For example, assume that a mandated benefits program requires employers to provide their employees with a benefit that has a value of $100. According to Summers's model, this results in a wage cut of $100 and has no effect on labor supply; therefore it is efficient.[88] Likewise, a tax-financed program that requires every employee to pay $100 in tax

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88. *See* Summers, *supra* note 4, at 180.

and provides each employee with a benefit that has a value of $100 has no effect on labor supply. The two tools of social policy are equally efficient. All the parties involved—employees, employers, and consumers—are indifferent as to whether the employees (1) receive a lower after-tax wage due to having paid higher taxes in return for certain benefits provided by the government or (2) receive the same lower after-tax wage due to having given up some of their wages in return for similar benefits provided by their employer. Therefore, there can be no fundamental difference in efficiency between mandated benefits and tax-financed programs. If the tax in this example had been calculated as a percentage of the wage, as taxes often are, it would have involved benefits that may have differed from costs. But this is not due to a fundamental difference in the efficiency of mandated benefits and tax-financed programs; it is due to a difference in the design of the particular tax.

Mandated benefits involve excess burden whenever the cost of providing the benefit is greater than the value that employees place on the benefit.[89] When the objective value of the benefit is greater than its subjective value—the value that employees place on it—it is not a deadweight loss because the burden is not a waste. The government uses the mandate to achieve a certain goal, such as the correction of market inefficiency or paternalism.[90]

The government can also use the mandate to benefit individuals other than the taxpayer.[91] In such cases, the difference between the cost of the benefit to the employers and the value that employees place on the benefit is not an excess burden. It is equivalent to a tax that raises revenue used either to provide merit goods or to overcome externalities. It is a tax "in kind"—it generates revenue, but not in the form of money. Only the part of the tax burden that does not benefit anyone in society is considered excess burden. This part is equivalent to the difference between the employer's cost of providing the mandated benefit and the benefit's objective value to the individual employee in cases of imperfect information, or to third parties in cases of externalities.

Mandated benefits involve a deadweight loss when the cost of providing the benefit is greater than the value that employees place on the benefit. Even if the wage rate is reduced by the full cost of providing

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89. *Id*. at 180–81.
90. *See* discussion *supra* Part III.B.
91. An example of this occurs where uninsured individuals benefit from health care financed by insured employees.

the benefit—with no decrease in the employment level—there is still a substitution effect. Leisure becomes less expensive because the value of the compensation for work (wages plus benefits) decreases. As previously mentioned, the mere fact that the labor supply has not changed does not mean that there is no excess burden. The excess burden is caused by the change in relative prices. When the cost of providing the benefit is greater than the benefit's value, there is a net decrease in the value of the compensation package; therefore, there is a change in relative prices. According to the theory of excess burden, such a change is inefficient. This can be grasped intuitively because forcing employees to purchase a benefit at a price higher than at which they value it reduces their welfare, whether or not it decreases their labor supply.

Whenever policymakers intervene in the labor market to supply workers with a tangible benefit, the benefit can be provided either in the form of mandated benefit or as a tax-financed program. Parental leave is a straightforward example. Under the Family and Medical Leave Act of 1993 (FMLA), employers are required to permit their employees to take up to twelve weeks a year of unpaid leave in the event that they, or an immediate family member, have a "serious health condition" or in the event that they have a newborn or newly adopted child.[92] The employer incurs costs in maintaining workers' jobs and in continuing health insurance premium payments on behalf of employees that are on family and medical leave.[93] Alternatively, one could think of a tax-financed program under which employees pay a tax that funds the payments to the health insurance company and to the employer to compensate for the costs the employer incurs when employees take parental leave.[94]

Employers who voluntarily provided parental leave programs prior to the enactment of the mandate (who therefore were not affected by the program) would not only pay taxes due to the tax-financed program but would receive benefits as well.[95] These benefits, at least in theory,

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92. *See* 29 U.S.C. §§ 2601–2654 (2000).

93. 29 U.S.C. § 2614(c). The employee can be required to repay his employer for health insurance costs upon the employee's failure to return to work after the leave. *See* Jane Waldfogel, *The Impact of the Family and Medical Leave Act*, 18 J. POL'Y ANALYSIS & MGMT. 281, 283 (1999) (estimating the cost at $250 per employee per year).

94. Virtually all industrialized countries mandate that employers provide job-protected leave from work after the birth of a child. None of these governments compensate employers for the costs they incur in securing jobs for employees during the employees' absences. Many countries, especially in Europe, provide the employee with income support financed through payroll taxes during the leave period. *See generally* Christopher J. Ruhm, *The Economic Consequences of Parental Leave Mandates: Lessons from Europe*, 113 Q.J. ECON. 285 (1998).

95. Under such a scheme, the government would pay the employers for the costs incurred in maintaining the employee's job during the time of the leave. Such costs include training a temporary replacement and possibly paying a higher wage (premium)

should offset the taxes paid by the employers to finance the parental leave program and should therefore result in no excess burden. The benefits provided by the government to the employers in return for the taxes serve three purposes. First, the benefits release the employers from paying their employees during the leave period, if under a mandated benefit program they were required to do so. Second, the benefits release the employers from paying for the employees' health insurance. Lastly, the benefits serve as compensation for the costs of securing jobs during the employees' absences from work.

B. Tax-Financed Programs Cause a "Government Provision Trap"[96]

Summers also argues that tax-financed programs may induce employers to not provide their employees with benefits of higher quality, which they would have offered in the absence of such tax-financed programs.[97] This is not a fundamental fault of tax-financed programs, but merely a problem with their current prevalent design.

Using a voucher as a part of the tax-financed program could eliminate the problem. A voucher is a capped or restricted subsidy that provides the recipient some freedom to choose how to spend the aid on limited types of goods or services.[98] Broadly defined, a voucher may be paid out in cash, paid in kind, or provided indirectly as a tax subsidy.[99]

Using a voucher would solve the government provision trap. Employers who supplied their employees with higher quality benefits prior to the enactment of the tax-financed program would continue to do so because the voucher would reimburse them for their costs up to the voucher's worth. Summers admits that public programs that partially compensate those seeking high quality, private sector benefits could avoid the government provision trap, but he dismisses the idea as

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to the replacement employee to compensate the employee for the employer's inability to offer the replacement employee a long-term employment contract.

    96*.   See* Summers, *supra* note 4, at 179 (citing Sam Peltzman, *The Effect of Government Subsidies-in-Kind on Private Expenditures: The Case of Higher Education*, 81 J. POL. ECON. 1 (1973) (discussing such a "government provision trap" in the context of higher education)).

    97.   *Id.* at 179–80.

    98*.   See* C. Eugene Steuerle, *Common Issues for Voucher Programs*, *in* VOUCHERS AND THE PROVISION OF PUBLIC SERVICES 3, 4–5 (C. Eugene Steuerle et al. eds., 2000). For an analysis of some basic economic issues presented by voucher-like programs, see David F. Bradford & Daniel N. Shaviro, *The Economics of Vouchers*, *in* VOUCHERS AND THE PROVISION OF PUBLIC SERVICES, *supra*, at 40.

    99.   Steuerle, *supra* note 98, at 4–5.

politically infeasible.[100]   He may be correct, but when comparing tax-financed programs to mandated benefits, the point should be restated as a political economy argument rather than as one based on efficiency.

The government provision trap is not a necessary result of tax-financed programs. It is the product of a faulty design that is based on a fiscal illusion.[101]   It should not count as a fundamental difference between mandated benefits and tax-financed programs.   Mandated benefits may be politically popular because they emphasize the benefits while hiding their costs.[102]   They are definitely more popular than explicit "taxes," but these are not essential differences in efficiency between mandated benefits and tax-financed programs.[103]   Moreover, current mandated benefits programs also have many faults in design, such as their usual imposition of fixed costs.   These fixed costs inefficiently and unjustly induce employment of full-time employees over part-time workers.[104]   Such faults should be taken into account when comparing mandated benefits and tax-financed programs.

C. Some Possible Efficiency Differences Between Mandated Benefits and Tax-Financed Programs

This Article has thus far clarified the Summers argument: The potential source of the excess burden of mandated benefits and tax-financed programs is the difference in incidences of costs and benefits. This Article has shown that, although excess burden is usually related to taxes, both social policy tools can have similar incidence issues and therefore entail similar types of excess burden.   There are, however, other efficiency arguments that might, in fact, separate mandated benefits and tax-financed programs.

First, some of the inefficiencies and distortions caused by taxes are not a result of the taxes' redistribution function.[105]   Using a tax to finance employment benefits may be less efficient than using a

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100.   *See* Summers, *supra* note 4, at 180 n.3.
101.   Most people would not appreciate the efficiency and distributive advantages of a system that refunds part of the expenses incurred by rich people who choose higher quality services over "free" government services.   People tend to concentrate on the immediate benefit that the rich receive, while ignoring the overall progressive picture. For a similar problem, see Daniel N. Shaviro, *Effective Marginal Tax Rates on Low Income Households*, 84 TAX NOTES 1191, 1192 (1999).
102.   *See* Krueger, *supra* note 13, at 298.
103.   The Social Security system uses similar tactics to hide its redistributive nature. *See* DANIEL SHAVIRO, MAKING SENSE OF SOCIAL SECURITY REFORM 104 (2000).
104.   *See* HAMERMESH, *supra* note 13, at 45–56.
105.   *See* Slemrod & Yitzhaki, *supra* note 9, at 199 ("[O]utside of an optimum, there is no necessary link between the distr[i]butional characteristics of a tax or public good and the revenue leakage associated with it.").

mandated benefit because of administrative costs of the tax system. These distortions caused by the tax system are in addition to the inefficiency attributed to the redistributive function of the tax. Mandated benefit programs may involve similar offsetting inefficiencies, such as noncompliance, which require monitoring costs.[106]

Evasion and avoidance, two sources of inefficiency usually discussed in the context of general taxes, are not relevant to tax-financed programs because the benefits are provided as a function of paying the tax. These inefficiencies are relevant to the extent that the tax-financed program has a redistributive function. Redistribution will usually be achieved by supplying a fixed benefit to all employees and imposing a tax that is computed as a percentage of the wage—possibly even at a progressive rate. In such a case, individuals may try to lower their taxed income and enjoy the same level of benefit. This can be achieved in two ways. The first is avoidance—either shifting compensation from taxed wages to non-taxed fringe benefits and working conditions or claiming any available deductions. The second is evasion—underreporting of income. Mandated benefits do not share such problems because the tax is being paid in the form of reduced wages.

Second, there are situations in which employers have some direct control over their own behavior or the behavior of their employees. For example, mandating employers to pay for work related injuries and illnesses, which is currently done by workers' compensation, might be efficient. It induces employers to enhance workplace safety to reduce expected payments to employees for work related injuries. Another example is unemployment insurance, assuming it is experience rated. The employer will keep layoffs at a minimum and share information with employees about expected downsizing or plant closings, giving them time to look for new jobs long before they are fired. In such situations, mandated benefits provide employers with incentives that would be complicated to achieve using a tax-financed program.

Third, the benefit is part of the work or the workplace itself. This includes, for example, exceptions to the employment-at-will doctrine[107]

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106. *See* Orley Ashenfelter & Robert S. Smith, *Compliance with the Minimum Wage Law*, 87 J. POL. ECON. 333 (1979).

107. For the latest empirical findings, see David H. Autor et al., The Costs of Wrongful Discharge Laws (Oct. 2, 2001) (unpublished working paper presented by John Donohue at New York University's Labor and Employment Law Center's Workshop (Oct. 16, 2001) (on file with author)).

and antidiscrimination laws.[108] If government intervention is needed to supply a component of the work itself, a tax-financed program cannot replace it. Work and the workplace environment provide more than just an income stream.[109]

V. REDISTRIBUTION OF INCOME FROM EMPLOYERS TO EMPLOYEES

A. Under the Basic Framework, No Such Redistribution Is Possible to Any of the Employees

Mandated benefits programs coerce employers to supply benefits to their employees. As previously discussed, this does not mean that employers are "footing the bill." This is a matter of tax incidence, usually discussed in connection with the question of who bears the burden of payroll taxes. Summers's basic model shows that employees will pay for the benefits with either a reduced wage rate or a decreased employment level.[110]

When the mandated benefits are of a fixed cost nature, such as a requirement that employers provide elevators at the workplace, the costs cannot be shifted to the employees who benefit from the mandate. For example, employers cannot reduce the wages of disabled employees to offset the cost incurred in building the elevators that enable the disabled employees' access to the workplace. This is due to the one-time nature of such costs; they do not affect the marginal cost of employing the disabled. Donohue gives a similar example, according to which the costs of a mandate that requires employers to eliminate neutral practices that unfairly impede certain group members receiving offers of employment cannot be shifted to the targeted employees.[111]

Summers and Jolls focus only on mandates that impose costs that increase with the number of hours of labor—per worker-hour costs. This type of cost is also the focus of this Article. When the employer's cost of providing the mandated benefit is greater than the employees' valuation of the benefit, the employer will first reduce the wages by an amount equivalent to the employees' valuation of the benefit. As

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108. *See* Jolls, *supra* note 2, at 226 (explaining how antidiscrimination laws may in some aspects be viewed as mandated benefits).

109. *See* Donohue, *supra* note 3, at 914 (noting that other scholars have "found that the average worker is benefited in terms of perceived happiness when personal income rises, but is far more adversely affected by being unemployed"); Amartya Sen, *Inequality, Unemployment and Contemporary Europe*, 136 INT'L LAB. REV. 155, 156 (1997).

110. Summers, *supra* note 4, at 180.

111. *See* Donohue, *supra* note 3, at 905–06; *see also* Tyler Cowen & Alexander Tabarrok, *Good Grapes and Bad Lobsters: Applying the Alchian and Allen Theorem*, 33 ECON. INQUIRY 253, 254 (1995).

previously mentioned, this has no labor supply implication because the value of the overall compensation package remains the same. The employer will then seek to lower wages by the remaining cost. This is the "tax" component of the mandated benefit,[112] which employers and employees will bear according to the relative elasticities of labor supply and demand.

Even if the labor supply is more elastic than the labor demand, meaning that employers will bear most of the tax burden, it does not mean that those employees are better off as a result of the mandated benefit. That is because the tax component has no incremental benefit value to the employees.[113] Whatever value the mandated benefit had, assuming that employees correctly assessed it, was already taken from them through a wage reduction.

Assuming that the labor supply is not perfectly inelastic, mandated benefits that have greater cost to the employers than value to the employees will produce a new equilibrium point to the southwest of the initial equilibrium point.[114] At this point, some employees will drop out of the labor market.

The employees who lost their jobs are clearly worse off, but so are the employees who maintained their jobs. Even though the new equilibrium point is at a higher wage point than it would have been had employers been able to reduce wages by the full cost of the mandated benefit, the employees who stayed in the labor market did not enjoy a wage increase. Their wages did not decrease by the full cost of providing the mandated benefit, but because the tax component of the mandated benefit had no value to them, they did not benefit from not having to fully pay for the benefit. They fully paid, through reduced wages, for the valued benefit part. It is only the tax component, which is worthless, that they did not fully pay for. Because they did pay for some of the tax component of the benefit, they too are worse off. This can be graphically demonstrated by focusing on the "workers' surplus."

Workers' surplus is the difference between the wage rate that workers are willing to receive and a higher wage rate that they actually do receive.

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112.   When the cost to employers of providing the benefit is greater than the value that employees place on the benefit, the difference is a net tax—or loss.
113.   This is true unless we assume that the mandated benefits actually have a greater value than the value that employees put on them, such as with merit goods or pensions. *See* discussion *infra* Part V.B.
114*.   See supra* fig.3, at Part II.A.

If one assumes that the labor supply curve slopes upward—meaning that workers offer more worker-hours as the wage rate increases—the wage rate at the equilibrium point is what employees, as a group, require for the marginal worker-hour. Even though they would be willing to provide, at a lower rate, all the work hours before the marginal one, the employees receive the marginal wage rate for *all* of the worker-hours that they supply.

Similarly, employers enjoy an "employer's surplus," which is the difference between the wage rate that they are willing to offer and the wage rate that they actually pay. Assuming that the labor demand curve slopes downward—meaning that less labor is demanded as the wage rate increases—the wage rate that is set at the equilibrium point is the rate that employers are willing to pay for the marginal worker-hour. Even though they are willing to pay higher wage rates for previous worker-hours, they pay this marginal wage rate for *all* the worker-hours that they purchase.

FIGURE 8
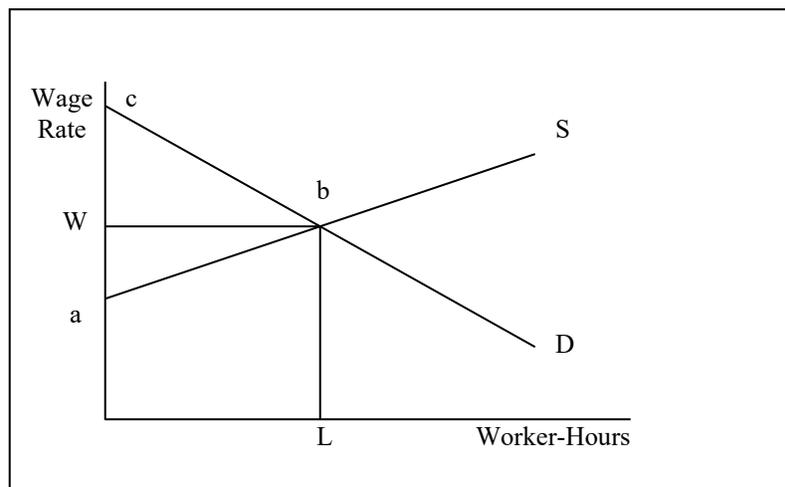
To illustrate, assume that there is only one employee, and that this employee is willing to offer services for $10 per hour for the first nineteen hours of work per week. The worker already requires $15 for the twentieth hour and $30 for the fortieth hour. Assuming that the demand for labor is such that the equilibrium point is set at forty hours a week, the worker's wage rate is $30 per hour. The worker receives this

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wage for every hour of the forty hours offered, not only for the fortieth hour. Therefore, the worker's surplus is the difference between $30 and the amount that the worker would have been willing to accept for each of the first thirty-nine hours per week.[115] This is depicted in Figure 8 as the area above the supply curve and below the horizontal line at the market wage rate—triangle *aWb*.

Employers enjoy a surplus as well. Because the wage rate set at the equilibrium point is lower than the wage rate they would have been willing to pay for fewer hours, and because they pay that same wage rate for all the hours up to the marginal hour, the employers gain as well. The employers' surplus is depicted in Figure 8 as the area under the demand curve and above the horizontal line at the market wage rate—triangle *cWb*. The existence of a surplus is a basic feature of an efficient market: all voluntary transactions are win-win. In other words, these voluntary transactions are Pareto improvements; all parties to them gain, or at least they do not lose.

The higher the employment rate, the greater the surplus enjoyed by both employers and employees. This occurs because the space of both triangles increases as the employment rate rises. Therefore, mandated benefits that result in a lower employment level decrease the economic gains of both employers and employees. Employees who maintain their jobs do not benefit from the mandated benefits even though their wage rate does not decrease by the full cost of the mandated benefit to their employers. This is depicted in Figure 9.

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115. In other words, the employee would receive a surplus of $20 ($30–$10) on the first hour, $15 ($30–$15) on the twentieth hour and so on, for the first thirty-nine worker-hours a week.

FIGURE 9
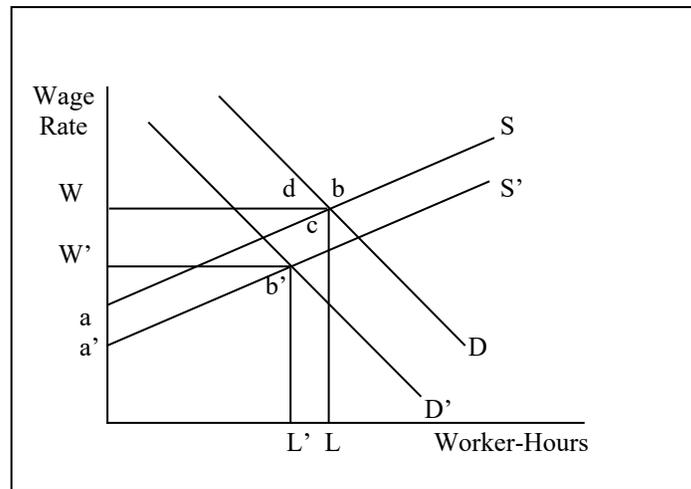
The workers providing the *L'* worker-hours—the workers who maintained their jobs after the enactment of the mandated benefits—realized a workers' surplus of *acdW* before the benefits were provided. This is clearly larger than the surplus of *a'b'W'*, the surplus realized after the benefits were provided.[116]

B. Redistribution to Some of the Employees

There are two exceptions to the general inability of mandated benefits to redistribute income from employers to *any* of the employees: (1) minimum wage laws and (2) benefits having objective values greater than the values that the employees place on them.

1. Minimum Wage Laws

Employees who earned a below minimum wage rate and, because of minimum wage laws, received an increase in their wages that was not offset by a reduction in any other part of their compensation package, such as free food or other fringe benefits, are better off as a result of the minimum wage laws. Note that employees *as a group* are not better off

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116. *See* Lee, *supra* note 11, at 404–05.

because, according to the basic framework, if the wage rate did not decrease, the employment level did. Therefore, some employees paid with their jobs for the benefits enjoyed by the employees who maintained their jobs and benefited from a wage increase.

Any mandated benefit can have this effect on employees earning the minimum wage. If the employees' compensation package does not include any voluntarily provided benefits—fringe benefits—then upon enactment of a new mandated benefit, the employer cannot reduce the employees' wage rate due to the minimum wage laws.[117] But this is true only in the short term. In the long run, these employees will end up paying for the benefit indirectly. Because the employer will strive to return to its pre-mandated benefit output, the employees will not receive wage rate increases that they otherwise would have received without the mandated benefit.

2. Benefits Having an "Objective Value" Greater than the Value Employees Place on Them

Mandated benefits may have redistribution effects if there is a difference between the employees' subjective evaluation of the benefits and the benefits' objective worth. This usually occurs when the benefit is the result of paternalism. Policymakers operate under the assumption that employees undervalue certain benefits, such as savings for retirement,[118] which means that these benefits have an objective value greater than their subjective value to the employees.

A heightened subjective value of the benefits can affect the size of the gain conferred on employees by the mandate. However, when the objective value is higher than the employees' subjective valuation of the benefits, redistribution takes place. Wage rates decrease only by the value the employees place on the benefits, and the additional cost results in a lower employment level.

Employees who maintain their jobs after the provision of the mandated benefit enjoy a compensation package with a greater objective value than its value prior to the provision benefit. Hence, the mandated

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117. *See* Gruber & Krueger, *supra* note 12, at 139 (noting that mandated health insurance may have greater adverse effects on the employment level, that is, less shifting of costs through lower wages, because the minimum wage is likely to be more of a constraint for uninsured workers).

118. *See, e.g.*, Deborah M. Weiss, *Paternalistic Pension Policy: Psychological Evidence and Economic Theory*, 58 U. CHI. L. REV. 1275, 1282–83 (1991).

benefits transferred some wealth to them. The wealth was transferred from two sources: (1) employers and (2) employees who quit because they misjudged the objective value of the benefits.

The employers lost because their profits decreased as a result of the decreased output at the new equilibrium point. The mandated benefits produced a net downward shift of the demand curve, as is shown in Figure 4. The vertical distance is the difference between the employees' subjective value of the benefits and the cost of the benefits. This difference is the tax component. At the new equilibrium point, the employment level is lower; therefore, the output is smaller. Employers prefer a higher output because they make a profit on that additional output. Profit is only possible at the prebenefit labor costs. Employers lose this incremental profit as a consequence of the mandated benefit.

Employees who lost their jobs as a result of the mandated benefit transfer wealth to those who stayed. By leaving the job, the employees prevented the wage rate from decreasing by the full cost of providing the benefit. The loss incurred by employees who left their jobs is the difference between the subjective value they placed on the benefits and the objective or real value of the benefits. The labor supply decreased by more than it would have had the employees valued the benefit correctly. The employees who left the workplace because of the mandated benefit, who would not have left had they known the objective value of the mandated benefit, transferred wealth to the employees who maintained their jobs. The employees who stayed on the job enjoy a compensation package that includes the objective value of the mandated benefit. This occurs although they only paid, by way of a wage reduction, for their subjective valuation of the benefits.

Generally, no redistribution can take place from employers to employees. Both exceptions to this rule describe government intervention that results in increased labor costs due to the provision of compensation that has real value to the employees but whose cost is not fully borne by the employees who stay on the job.[119] In the case of a minimum wage, the law forbids the wage reduction; in the case of all other mandated benefits, the excessive decline in labor supply prevents the wage reduction. This decline in the employment level is excessive because it is due to the employees' undervaluation of the benefits.

There is an important difference between minimum wage laws and mandated benefits that have a greater objective than subjective value. Employees who were laid off in the case of minimum wage laws are probably the weakest ones.[120] With other forms of mandated benefits,

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119. Their wages decline by less than the value of the benefits they receive.
120. *See* Shaviro, *supra* note 16, at 417 (noting that the employees who are most

the employees who leave their jobs due to their subjectively low valuation of the new benefits require a higher compensation package; thus, they may have a greater endowment.

VI. ACCOMMODATION MANDATES REDISTRIBUTE INCOME BETWEEN GROUPS OF EMPLOYEES

Summers noted that wage rigidity might form an exception to his model when employers are required to "pay different workers the same wage even though the cost of providing benefits differs."[121] This includes, for example, limiting an employer's ability to reduce a worker's wages when the employer pays a higher health insurance premium because of the employee's advanced age.[122] Summers viewed this as an efficiency problem; he assumed that employers would find a way to avoid hiring people with high mandated benefits costs.[123]

Christine Jolls developed this wage rigidity exception, comprehensively examining its redistributive effects.[124] She analyzed mandated benefits targeted at specific groups of employees—in her usage, "accommodation mandates"—which ordinarily is how costs of providing the benefit differ.[125] Jolls showed that if limitations on both wages and employment levels are binding, mandated benefits might have a redistributive effect.[126] The mandated benefits improve the relative position of the targeted group members compared to all other employees.[127] The

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likely to lose their jobs due to an increase in minimum wage are those who have the least marketable skills).

121. Summers, *supra* note 4, at 181. With regard to minimum wage laws, Summers commented that the wage rigidity they cause has similar effects under both tax-financed programs and mandated benefits; thus, they are not relevant when comparing the two social tools. *See id.* at 181–82.

122. *Id.*

123. *Id.* at 181.

124. Jolls, *supra* note 2 *passim*.

125. Parental leave programs for parents are an example of this.

126. Jolls further analyzed what happens when restrictions constrain employers from differentiating wages, but not employment levels. She posited that an antidiscrimination law itself has similar effects to accommodation benefits in this context and should therefore be analyzed in the same way. *Id.* This latter point has important implications in determining Congress's power to enact various federal employment laws under Section 5 of the Fourteenth Amendment to the U.S. Constitution, a point more fully developed by Jolls in another paper. *See* Christine Jolls, *Antidiscrimination and Accommodation*, 115 HARV. L. REV. 642 (2001).

127. Because the targeted employees receive a benefit, the cost of which is borne by all employees, the targeted employees are relatively better off.

employer's labor costs increase, but the employer is not permitted to offset the costs by reducing only the wages of the employees that are helped by the mandated benefits. Therefore, all employees, including those who are not aided by the mandated benefits, share equally in the cost of providing the benefits.

As Jolls pointed out, the extent of the actual redistribution depends on two combined factors: (1) the size of the difference between the value of the benefits to the targeted employees and the benefits' cost to the employer, referred to as the "net tax" component of the mandated benefits, and (2) the percentage of targeted employees out of the total number of employees.[128] If the tax component and the percentage of targeted employees are relatively large, it is possible that the mandated benefits will make even the targeted employees worse off, while the targeted employees' relative position compared to the other employees will improve.[129] This effect may still satisfy a policymaker's redistribution motive because it will narrow inequality between those two groups at the same workplace, assuming that the targeted employees were initially disadvantaged. When the tax component and the percentage of targeted employees are both relatively small, the targeted mandated benefits will have a normal and actual redistribution effect.[130] Wealth will be transferred from everyone to the targeted employees because the targeted employees are the only ones to benefit from the mandate, though everyone shares with them in the cost.

VII. Beyond Traditional Accommodation Mandates

This Part demonstrates that a number of real world mandates disproportionately target or benefit a particular discrete demographic group that could be identified in advance. Nevertheless, these types of accommodation mandates differ from those discussed by Jolls in that they are *unintended* by policymakers and might redistribute wealth in the direction opposite from that which society usually views as desirable. The mandates that Jolls discussed could hurt their intended beneficiaries if restrictions on wage and employment differentials were not binding.[131]

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128. Jolls, *supra* note 2, at 249–50.
129. *Id.*
130. The targeted employees will be made better off by getting a benefit that they value at more than their wage decrease. The benefit is financed by a reduction in the wages of all employees, including the nontargeted employees, who do not share in the benefit. This is, in effect, a transfer from the nontargeted to the targeted employees.
131. The wage could be reduced by more than the value of the benefits to the targeted employees. Alternatively, if the wage were binding, employers could refrain from hiring targeted employees, thus increasing unemployment rates among the targeted group members.

Conversely, these mandates are ones in which, if restrictions on wage and employment differentials bind, groups to whom society would normally want to redistribute—women and lower compensated employees—will be made worse off.

Moreover, in some of the examples presented, the redistribution occurs even in the absence of an antidiscrimination rule. This happens because the wage rigidity is the outcome of transaction costs that bar the employer from adjusting wages to offset the differences in values that employees place on the mandates.[132]

A. Wealth

Wealth differences do not actually deal with different groups, but rather they vary along a continuum of workers. However, such variations can be discussed as the differences between the values that the rich and the poor employees place on the benefits.[133]

Cash is always preferred to a benefit because it has the advantage of liquidity. Because cash can always be used to purchase the benefit, it gives the individual a greater freedom of choice. But poor individuals are even more likely to prefer cash to benefits because they have a higher marginal utility for marginal changes in their wealth. They need income to purchase goods that are more of a necessity to them. Relative to such goods, the benefits offered by the employer are viewed as luxurious and therefore have lower utility.[134]

In addition to the difference in their marginal utilities of income, rich and poor workers also vary in their tax brackets. When mandated benefits are correlated with tax advantages, such as tax exemptions or deductions, it is clear that high income employees value the benefits

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132. *See* discussion *infra* Part VII.C.
133. In most cases where workers are separated into groups, a closer examination would reveal a continuum. For administrative reasons, the grouping is done by arbitrarily drawing a line. This line is obvious in the context of tax and transfer systems, as when only poor people are entitled to certain benefits—a policy that involves great distortions, see generally Shaviro, *supra* note 101—but it can also be found in many other contexts, such as in the difference between an independent contractor and an employee.
134. *See* Joseph Bankman, *The Effect of Anti-Discrimination Provisions on Rank-and-File Compensation*, 72 WASH. U. L.Q. 597, 603 (1994) (reasoning that low income employees would put a lower dollar value on retirement benefits than high income employees because they need most of their cash compensation to pay for bare necessities, such as food, rent, and child care, and stating that the same is true for medical insurance that is beyond necessity level).

more than low income employees.[135]   Tax advantages are given to taxpayers as a means of inducing certain behaviors perceived by the policymaker to be desirable.

A policy that both mandates and subsidizes the benefits seems to be implausible; if the policymaker has already decided to coerce a certain behavior, then what use could be found for incentives? However, this can happen in at least two situations: (1) when a benefit is not directly mandated, but the employer must offer it to every employee if the employer wants to offer it at all, and there are tax incentives to induce employers to offer such benefits;[136] and (2) when administrative reasons, such as the difficulties associated with distinguishing between private and business expenses, lead to the exclusion of the benefits from the tax basis.[137]

Empirical studies suggest that rising income is positively correlated with an increasing proportion of benefits in total compensation.[138]   As long as there is a clear relation between wealth and the subjective value of the mandated benefits, a benefit has greater value to high income employees than to low income employees. Assuming that employers do not take income level into account and do not reduce the wages of high income employees to a greater extent than low income employees, mandated benefits redistribute income from poor to rich employees.

Assume, for example, that prior to the enactment of a mandated benefit, a rich employee earns $100 per hour and a poor employee earns $10 per hour. A mandate requires the employer to contribute ten percent of its employees' wages to retirement accounts on their behalf. The employer will therefore reduce the wage paid to the rich employee by $10 per hour and reduce the wage paid to the poor employee by $1 per hour. Both employees will probably value the benefit at less than its cost, as most people prefer to have the ability to choose between present and future consumption. The mandate is paternalistic because it coerces

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135.   Exemptions or deductions shelter income from tax according to the marginal tax rate of the taxpayer. High income taxpayers pay taxes at higher tax rates than low income taxpayers, and they therefore derive greater benefits from the deductions or exemptions.

136.   *See* Bankman, *supra* note 134, at 599–600; Daniel I. Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1, 18 (1993).

137.   An example is the tax treatment of fringe benefits.

138.   *See generally* Stephen A. Woodbury, *Substitution Between Wage and Nonwage Benefits*, 73 AM. ECON. REV. 166 (1983). The amount of the increase in benefits that was attributed to rising marginal taxes and the amount that was attributed to rising incomes remains unclear. But this is of no relevance to the argument here. One researcher suggested the following explanation: rising incomes increase the value of time to workers, so high income employees prefer benefit programs that assign others to take care of their personal administrative details, such as insurance and pension. *See* Richard A. Lester, *Benefits as a Preferred Form of Compensation*, 33 S. ECON. J. 488, 490 (1967).

the employees into saving for retirement.[139]

But compared with rich employees, poor employees will place a relatively lower value on the benefit. In this example, the poor employees may place a value of $.70 on each dollar of mandated savings, while high income employees may place a value of $.99 on each dollar of mandated savings. The differences in valuation are the result of differences in marginal utilities of current consumption, differences in tax benefits, which were not mentioned in this example. There is also an additional reason that is relevant in the context of this specific example: the ability of the rich employees to offset the effects of the mandated benefit by reducing their voluntary savings.[140] Unless the employer reduces the wages of the rich employees by a greater percentage than it reduces the wages of the poor employees, the mandated benefit will have a regressive redistributive effect, transferring wealth from poor employees to rich employees.

Alternatively, specific mandated benefits may be more beneficial to low income employees. Examples would include basic medical insurance (assuming it is not available to nonworkers) and anti-sexual harassment laws[141] (assuming that poor women are more vulnerable to sexual harassment at work).

B. Gender

1. Overtime Pay

One well-known difference between the sexes is the number of hours spent at work. Men tend to work longer hours than women and therefore benefit from mandated overtime pay to a greater extent than women, who generally tend not to work overtime.[142] According to the Current

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139. The policymaker assumes that people are myopic—they do not save enough for retirement and will regret it when old. Therefore, the policymaker forces employees to save certain minimal amounts by mandating it.

140. The richer the employees are and the higher their preferences for savings (future consumption), the greater the likelihood that the employees already voluntarily saved for retirement prior to the enactment of the mandated benefit. Therefore, the value that they place on the benefit may reach 100%—assuming, realistically, zero transaction costs incurred in decreasing the level of the voluntary savings.

141. These can also be seen as targeted mandated benefits—accommodation benefits, as defined by Donohue. *See* Donohue, *supra* note 3, at 903–04.

142. The Fair Labor Standards Act of 1938 requires the payment of time-and-a-half wages for overtime. 29 U.S.C § 207(a)(1) (2000).

Population Survey (CPS) of 2001,[143] the average working hours of women holding full time wage and salary jobs in the nonagricultural industries is 40.9 hours a week compared to 44.2 hours for men. This translates to a gap of 3.3 hours per week. Within the overtime zone, the rate of women's participation drops dramatically. Out of the total population of workers working more than forty hours, 67.5% are men and only 32.5% are women.[144] This means that two out of three employees who may be eligible for overtime pay are men. In the extended workload category—those working more than forty-nine hours per week—72.2% are men.[145] Hence, in the group of workers eligible for at least nine hours of overtime pay, seven out of ten are men. Empirical studies suggest that employers reduce the regular hourly wage they pay to offset the costs of overtime premium changes.[146] Thus, the costs of overtime payment are shifted to the employees.

Both Gruber's study of the incidence of mandated maternity benefits[147] and Jolls's paper suggest that redistribution between the sexes may not take place.[148] Gruber found that employers shifted the costs of additional insurance premiums to women who were the likely beneficiaries of that mandate.[149] Furthermore, Jolls has argued that occupational segregation may preclude redistribution in either direction within the context of gender.[150] But, as Jolls points out, segregation is declining, so the overtime rules might lower women's wages while benefiting men. As for the Gruber study, it looked at the 1970s;[151] according to Jolls's paper, occupational segregation has decreased substantially since then.[152] In addition, there is a salient difference if the mandate is not *on its face* targeted at a specific group. The examples discussed in this Part are substantially different from the mandated benefits that Gruber studied.[153]

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143. Bureau of Labor Statistics, *Table 22: Persons at Work in Nonagricultural Industries by Age, Sex, Race, Marital Status, and Usual Full- or Part-Time Status* (2001), http://www.bls.gov/cps/cpssaat22.pdf.

144. *Id.*

145. *Id.*

146. *See* STEPHEN J. TREJO, DOES THE STATUTORY OVERTIME PREMIUM DISCOURAGE LONG WORKWEEKS? *passim* (IZA Discussion Paper No. 373, 2001); Stephen J. Trejo, *The Effects of Overtime Pay Regulation on Worker Compensation*, 81 AM. ECON. REV. 719, 720 (1991).

147. *See* Gruber, *supra* note 7.

148. Women pay for the benefits they receive by accepting reduced wages.

149. Gruber, *supra* note 7, at 639.

150. Jolls, *supra* note 2, at 268–70.

151. Gruber, *supra* note 7, at 623–24.

152. *See* Jolls, *supra* note 2, at 287 (noting, however, that occupational segregation is still quite significant).

153. Gruber studied health insurance coverage, the cost of which is measured explicitly and accurately by the additional premium charged. *See* Gruber, *supra* note 7, at 622.

It is a plausible assumption that employers reduce the regular hourly wage of all their employees, not only of the employees who are paid an overtime premium. Otherwise, employees who are paid an overtime premium will refuse to work overtime, as they might believe the employer overestimated the subjective value of the premium.

Thus, it is plausible to assume that the overtime pay mandate is effectively binding, not because of antidiscrimination laws, which are not present in this context, but because of the employers' transaction costs and workplace norms.[154] Employers do not lower the regular wages of the benefited employees and hold the wages of the nonbenefited employees constant. Rather, the outcome is an unintended redistribution from women to men, as the benefits of the overtime pay mandate are concentrated with men, while the costs are borne by all employees—women and men alike.

2. Vesting Requirements

Yet another difference between men and women is the number of years that they stay in one workplace. Women tend to experience work interruptions much more frequently than do men.[155] Therefore, there is a gap in tenure between men and women.[156] Certain mandated benefits are provided only to employees who satisfy waiting, recency, and vesting periods.[157] Rules governing mandated contributions to employees' pension plans are a good example of this requirement.[158] Antidiscrimination

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154.   *See* BEWLEY, *supra* note 24, at 41–56, 70–85 (noting that employees compare wages and the importance of internal pay equity).

155.   *See* Mary E. O'Connell, *On the Fringe: Rethinking the Link Between Wages and Benefits*, 67 TUL. L. REV. 1421, 1453 (1993); Camilla E. Watson, *The Pension Game: Age- and Gender-Based Inequities in the Retirement System*, 25 GA. L. REV. 1, 20–22 (1990).

156.   *See* Bureau of Labor Statistics, *Table 1: Median Years of Tenure with Current Employer for Employed Wage and Salary Workers by Age and Sex, Selected Years, 1983–2000*, *at* http://www.bls.gov/news.release/tenure.t01.htm (last visited Jan. 26, 2003) (showing that men consistently experience longer working periods with the same employer than women do).

157.   *See* O'Connell, *supra* note 155, at 1450–60 (defining and explaining waiting periods, vesting requirements, and recency requirements).

158.   The Internal Revenue Code allows employers to forfeit the right to 100% of the employee's accrued benefit derived from employer contribution if the employee did not complete at least five years of service. I.R.C. § 411(a)(2)(A) (2000). The Code also allows the nonforfeitable percentage to gradually increase over four years, starting with the completion of three years of service and ending in the seventh year. I.R.C. § 411(a)(2)(B) (2000). Similar rules can be found in § 203(a)(2)(A) and (B) of ERISA. *See* 29 U.S.C. § 1053(a)(2)(A)–(B) (2000).

clauses in the tax code mandate that employers must provide their high and low income employees with pension benefits at the same ratio of benefits to total compensation.[159] Because there are tax incentives to providing the benefits to high income employees, employers often provide pension plans, and because of antidiscrimination rules, a large percentage of employees receive them.

In the context of differences in wealth, this Article previously discussed that such benefits might be to the detriment of the low paid employees. But even assuming that the employer takes into account the smaller value that low income employees place on the benefits and shifts a lower percentage of the benefits' costs to the low income employees, there still is a group of employees who value the benefits even less and are not being compensated for that by higher wages. This group includes employees who move from one workplace to another before satisfying the vesting requirement,[160] who thus cannot keep the employers' contributions to their plans.[161] Women compose a large percentage of this group. The employer does not know ahead of time that these employees will not stay long enough to satisfy the vesting requirement; therefore, the employer does not pay them a higher wage that would reflect the fact that these employees do not benefit from the plan. Employees who think they will not stay long enough in the same workplace to satisfy the minimum service requirement place zero value on the mandated pension plan, but their wages do not reflect their reduced future benefit. They therefore suffer either a wage decrease—compared to the other employees—or lower employment, depending on the elasticity of their labor supply.

This results in a redistribution of wealth from a group of relatively weak employees to employees who tend to be better off. The redistribution is caused by the different values that different employees place on the mandate that they receive. High income employees place greater value on mandated pension benefits than low income employees. For employees who do not intend to stay at least five (or sometimes three) years in the same workplace, the benefit is completely worthless. Women, especially married women of childbearing age, often belong to this latter group.[162]

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159. I.R.C. § 401(a)(4)–(5) (2000).
160. *See generally* Gillian Lester, *Careers and Contingency*, 51 STAN. L. REV. 73 (1998) (discussing a broader group of employees, the "contingent employees," defined to include all employees who are not core employees—part time employees and those working from home who lack job security and frequently move from one job to another, which accounts for a rapidly growing percentage of the labor market).
161. *See supra* note 158.
162. *See* O'Connell, *supra* note 155, at 1453.

These findings suggest that the differences in the values that employees place on mandated benefits are not random; rather, they correlate with family status and gender. It seems unlikely that employers adjust wages or their hiring decisions to account for these differences. Unlike the case of maternity health insurance studied by Gruber,[163] the benefits of the mandate are not explicitly tied to gender. Therefore, it is less likely that employers will reduce men's wages relative to women's wages to reflect the greater value that men place on such mandates.

3. Risk Aversion

Another difference between men and women seems to be work related risk aversion. A recent study finds that single fathers are more averse to work related risk than married fathers and that the latter are more risk averse than male employees who do not have children.[164] The research also found a difference between the genders.[165] The most safety oriented group of men—single dads—has been found to have the same level of risk aversion as the least safety oriented group of women—married women without children.[166] Safety related mandated benefits might be very costly.

This last example may be classified as a transfer from men to women because women place higher value on mandated safety measures. The empirical basis for this example seems to be weaker than the overtime pay and job tenure examples; therefore, the net redistribution effects of these three examples may be a transfer from women to men.

Moreover, safety mandates are probably the strongest example of mandates justified on a paternalistic basis. If viewed from this vantage, it may be possible to differentiate between this example and the previous ones and to see the mandate as benefiting men—even though they place a low value on it. Men benefit from a safety mandate to a greater extent than do women because men tend to take riskier jobs.[167] This might offset the redistributive effect derived from forcing men to pay the same price for safety that women pay, despite the fact that men place a lower value on it.

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163.   *See* Gruber, *supra* note 7.
164.   *See* THOMAS DELEIRE & HELEN LEVY, GENDER, OCCUPATION CHOICE AND THE RISK OF DEATH AT WORK 15–16 (Nat'l Bureau of Econ. Research, Working Paper No. 8574, 2001).
165.   *Id*.
166.   *Id*.
167.   *Id*. at 15.

C. Why Employers Would Not Offset Differences in Values by Wage Adjustments

Under the framework of accommodation mandates developed by Jolls, redistribution takes place only in the presence of fully binding antidiscrimination laws.[168] Otherwise, employers are able to shift the costs to the benefited employees and prevent redistribution. In the above examples—differences in wealth, overtime pay and vesting rules—no antidiscrimination rules were present, yet redistribution was assumed to take place.

What enables the redistribution? The answer is wage rigidity. Antidiscrimination laws are merely one possible type of wage rigidity. In the context of the examples presented above, the wage rigidities were caused by transaction costs, workplace norms, and even general social norms.

Social norms may prevent women from working overtime, even if they would otherwise want to do so. Workplace norms may prevent employers from reducing the regular wages of employees who work overtime because employees can easily compare wage rates, although it is more difficult to accurately assess the value of a benefit. Therefore, employers may prefer to pay similar wage rates to all their employees who do the same regular work. This may prevent turmoil among employees who receive a relatively lower wage rate because the employer believes that the employees place relatively high value on the mandated benefits—in this example, the high premium paid for overtime. Those employees may demand to be paid the same wage rate as their peers, rejecting the employer's claim regarding the higher value that they allegedly place on the benefits.[169]

Transaction costs may reflect costs incurred by the employer in obtaining the information necessary to offset the differences in values that employees place on their mandated benefits. Employers need to be able to measure these differences. Over the years, economists have developed a few methods to measure what they call "the cash-equivalent value of the benefit,"[170] but it is widely accepted that there is no accurate way to conduct these measurements.[171] Most studies simply assume that the employees' value is equal to the employer's cost—an assumption

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168. *See generally* Jolls, *supra* note 2.
169. *See* BEWLEY, *supra* note 24, at 70–85 (describing the importance of internal pay equity).
170. *See* DeLeire & Levy, *supra* note 164.
171. *Id.*

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that is not helpful for conducting distributional analysis.[172]

Employers have only limited knowledge of the personal lives of their employees. They can not assess the likelihood that specific employees will stay with them for many years; hence, they do not know the value that employees place on pension and other benefits that are subject to vesting periods. As mentioned above, women on average tend to incur more work interruptions than men. However, there are very substantial differences among women in this respect, probably more than in the context of maternity, and employers are unable to tell whether or not their female employees are likely to stay with them for many years.

Administrative reasons are therefore significant bars to accurate wage adjustments. Moreover, when taking into account the fact that labor supply is highly inelastic relative to labor demand, employers will not be willing to incur high administrative costs to adjust their employees' wages because they can shift almost all of their costs to the employees as a group.

VIII. CONCLUSION

Mandates come in many different shapes and sizes, and one needs to size up the particular mandate under consideration in assessing (1) how it compares to a tax-financed program from a distortionary standpoint,[173] and (2) what the likely distributive effects will be. This Article has gone beyond traditional accommodation mandates by looking at several thought provoking cases, such as overtime and pension vesting, which turn out to be just like accommodation mandates but have distributive effects potentially running in the opposite direction. This Article also has gone beyond the classic case of the distortions discussion—mandated health insurance versus tax-financed government provided health care— to explore situations in which exclusion of nonemployees seems plausible and sensible.

Except in cases where mandated benefits are required to accomplish policy goals that cannot be expressed in pecuniary terms, such as guaranteeing actual employment and not merely the income from labor,[174] any mandated benefit can be replaced by a tax-financed

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172. *See* Melissa Famulari & Marilyn E. Manser, *Employer-Provided Benefits: Employer Cost Versus Employee Value*, MONTHLY LAB. REV., Dec. 1989, at 24, 28.
173. *See infra* Part IV.A.2 (discussing excess burden).
174. *See* discussion *infra* Part IV.C.

program and vice versa. Both of these social policy tools can therefore be defined as taxes. There is no difference between using a tax to finance a government benefit and mandating the employer to provide the benefit, thus inflicting a cost that theoretically is equal to a tax. Under both scenarios, employers and employees will share the burden in the same way according to the relative elasticities of labor supply and demand. In some circumstances, a mandated benefit might be the more appropriate social tool; in other circumstances, a tax-financed program might be the best option. Hence, the selection of a tool to correct labor market inefficiency should be made on a case-by-case basis.