

## **POLICY DISINCENTIVES IN MAINTAINING LABOR FORCE ATTACHMENT**

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Connecting More People to Work  
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Mr. Chairman and members of the committee, thank you for inviting me to testify today. I am a senior research fellow at the Mercatus Center at George Mason, where I study the US economy, the federal budget, and tax policy.

Policies that ensure American workers can stay attached to the labor market are worth pursuing. Unfortunately, government policies at the federal, state, and local levels today make it harder for some workers to tap into particular markets in which workers are paid higher wages and are most productive. As a result, some workers stay idle. The following are the main points of my testimony today:

1. The labor market and the state of American workers are better than commonly suggested.
2. A small but sizeable segment of working-age Americans have not shared in that progress, as they have been permanently disconnected from the labor force.
3. Government policies such as land use regulation, occupational licensing, and Social Security disability insurance (SSDI) are some of the barriers that may induce some workers to work less or not at all.

### **AMERICAN WORKERS IN A DYNAMIC ECONOMY**

A common view across the political spectrum is that most American workers are falling behind or are barely getting by. Thankfully, in reality, the state of American workers is more positive.

It is true that, according to conventional measurement, real wages have been stagnant over the past several decades. This measurement, however, deflates nominal wages using the Consumer Price Index for All Urban Consumers (CPI-U). It overstates inflation and, hence, understates real gains in purchasing power.<sup>1</sup> Using the more accurate Personal Consumption Expenditures (PCE) deflator, the average real wage has grown by 24 percent from 1975 to 2015. According to the Federal Reserve Bank of St. Louis, real worker compensation per hour, which combines wages and benefits, climbed by 51 percent between 1973 and 2018.<sup>2</sup>

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<sup>1</sup> Brent R. Moulton, *The Measurement of Output, Prices, and Productivity: What's Changed since the Boskin Commission?* (Washington, DC: Brookings Institution, July 2018).

<sup>2</sup> Federal Reserve Bank of St. Louis, "Nonfarm Business Sector: Real Compensation Per Hour," November 6, 2019, <https://fred.stlouisfed.org/series/COMPRNFB#0>.

The same is true of real median household income. Measured properly, in 2018 the real median household income was significantly higher than it was in 1973. In addition, smaller household size means fewer potential earners and lower household expenses per member. After adjusting using the more accurate inflation deflator, and after normalizing household size, real median household income has risen by 50 percent during the past 50 years, rather than by the 21 percent reported in US Census data.<sup>3</sup>

Unemployment today is near a 50-year low, no matter how one measures it. The labor force participation rate (LPR) has been trending down over the past two decades, but it remains higher than it was in the 1950s, 1960s, and 1970s. Furthermore, the drop in the LPR among prime-age males began decades before 1990. What *has* changed significantly since 1990 is the slowdown in the rise of the LPR of working-age females. In addition, a large majority of men who dropped out of the labor force report exiting to pursue education, to retire, or be on disability. None of these reasons signal a dysfunctional economy.

Meanwhile, over the past three decades, the private service sector has created over 41 million net new jobs, many of which are in high-paying service sectors such as business and professional services, financial activities, management, healthcare, and education. While millions of manufacturing and other “middle skill” jobs have been eliminated, that decline has been more than offset by the increase in high-skilled jobs. What’s more, economist David Autor finds that “there is essentially no aggregate change in the share of workers employed in traditionally low-skilled jobs over the course of 45 years,” which led him to conclude, “Thus, in aggregate, occupational polarization appears to be a case of the middle-class joining the upper-class, which is not something that economists should worry about.”<sup>4</sup>

## ADJUSTMENT AND ATTACHMENT ISSUES

Despite the current low unemployment rate and an economy that is widely considered to be at full employment, data show that a small but sizeable segment of working-age Americans, disproportionately working-age men, have dropped out of the labor force entirely. This phenomenon has rightfully received serious attention from scholars and policymakers.

Some of the most commonly cited reasons behind the decline are skills-biased technological change and trade competition. For instance, a widely discussed paper, “The China Shock,” Autor, David Dorn, and Gordon Hanson highlight the fact that trade competition with China between 1999 and 2011 could have displaced as many as 2.4 million lost jobs, with 1 million of those jobs in manufacturing.<sup>5</sup> The authors also show that the effect of the shock could be persistent, and that it produced far more disruption than benefits for *some* workers.<sup>6</sup>

However, contrary to the way the findings of “The China Shock” have been presented not only in the press but even in the broader academic and policy worlds, “The China Shock” does *not* highlight an issue with trade competition per se. First, the paper ignores the large and documented benefits of increased trade with China over the past two decades.<sup>7</sup> It also does not account for offsetting job

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<sup>3</sup> William R. Cline, “U.S. Median Household Income Has Risen More Than You Think,” *Cato Journal* 39, no. 1 (Winter 2019): 221–22.

<sup>4</sup> David H. Autor, “Work of the Past, Work of the Future” (NBER Working Paper No. 25588, National Bureau of Economic Research, Cambridge, MA, February 2019), 5.

<sup>5</sup> David H. Autor, David Dorn, and Gordon H. Hanson, “The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade” (NBER Working Paper No. 21906, National Bureau of Economic Research, Cambridge, MA, January 2016), 25.

<sup>6</sup> Autor, Dorn, and Hanson, “The China Shock,” 29.

<sup>7</sup> Xavier Jaravel and Erick Sager, “What are the Price Effects of Trade? Evidence from the U.S. and Implications for Quantitative Trade Models” (CEP Discussion Paper No. 1642, London, August 2019); Mary Amity et al., “How Did China’s WTO Entry Benefit U.S. Consumers?” (NBER Working Paper No. 23487, National Bureau of Economic Research, Cambridge, MA, December 2018); Christian Broda, “China and Wal-Mart: Champions of Equality,” *Vox* (Centre for Economic Policy Research), July 3, 2008; Pablo D. Fajgelbaum, Amit K. Khandelwal, “Measuring the Unequal Gains from Trade” (NBER Working Paper No. 20331, National Bureau of Economic Research, Cambridge, MA, August 2015).

creation elsewhere in the US economy. Since then, many economic studies have found that the net aggregate effect on jobs of increased US trade with China is *zero*.<sup>8</sup>

The ultimate conclusion from all these studies, however, isn't that the sudden increase of trade with China didn't cause any serious disruption in the US labor market or in local labor markets—it did. The most important lesson is that American workers confronted with economic disruptions today face relatively new, more serious problems than they were facing before. In the past, economic shocks like the one caused by Chinese import competition were followed by an increase in the unemployment rate. But as people moved away to find jobs or changed jobs, unemployment returned to a lower level.<sup>9</sup> “The China Shock” exposed that, in *this* case, Americans, especially those who are not college educated, didn't move away and instead remained in hard-hit locales and stayed unemployed.

## THE ROLE OF GOVERNMENT POLICIES

The reasons behind the phenomenon of a growing group of working-age Americans detached from the labor market are complex and not open to simple or easy policy responses. That said, before rushing to adopt new or expanded federal interventions in labor markets, policymakers should first look at *government* policies that cause or exacerbate the issue. These policies reduce interstate mobility and may induce workers on the margin to work less or not at all, and they are in desperate need of reform. Without changes, other federal attempts to address the challenge of disconnection from the labor force could be moot.

I will highlight a few of them here.

### LAND USE

A large body of economic research strongly suggests that land and zoning regulations have played a crucial role in exacerbating adjustment issues. These regulations increase the cost of housing in higher-wage areas and make it harder to move there.<sup>10</sup> Standard estimates say that even *modest* housing deregulation would lead to a large increase in the supply of housing in the most prosperous areas of the country, which would soon be followed by economic migration to these areas. That would raise US GDP by between 2 percent and 9 percent,<sup>11</sup> reducing poverty and inequality in the process by giving lower-income workers greater access to higher-wage labor markets.<sup>12</sup>

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<sup>8</sup> Robert C. Feenstra and Akira Sasahara, “The ‘China Shock,’ Exports and U.S. Employment: A Global Input-Output Analysis” (NBER Working Paper No. 24022, National Bureau of Economic Research, Cambridge, MA, November 2017), 35; Alex Tabarok, “The China Shock was Matched by a China Boom,” *Marginal Revolution*, January 22, 2018; Phil Levy, “Did China Trade Cost the United States 2.4 Million Jobs?,” *Foreign Policy*, May 8, 2016; Scott Sumner, “Autor, Dorn, and Hanson on the China Shock,” *Library of Economics and Liberty*, February 26, 2016; Brad DeLong, “Globalization: What Did Paul Krugman Miss?,” *DeLong's Grasping Reality*, March 23, 2018; Douglas A. Irwin, *Clashing over Commerce: A History of US Trade Policy* (Chicago: University of Chicago Press, 2017); Douglas Clement, “Interview with David Autor,” *The Region* (Federal Reserve Bank of Minneapolis), September 7, 2016; Stephen J. Dubner, “Did China Eat America's Jobs?,” January 25, 2017, in *Freakonomics Radio*, produced by Greg Rosalsky, podcast, MP3 audio, <http://freakonomics.com/podcast/china-eat-americas-jobs/>.

<sup>9</sup> David Schleicher, “Stuck! The Law and Economics of Residential Stagnation,” *Yale Law Journal* 127, no. 1 (2017): 78–154.

<sup>10</sup> Kevin Erdmann, Salim Furth and Emily Hamilton, “The Link Between Local Zoning Policy and Housing Affordability in America's Cities” (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, March 2019).

<sup>11</sup> Edward Glaeser and Joseph Gyourko, “The Economic Implications of Housing Supply,” *Journal of Economic Perspectives* 32, no. 1, (Winter 2018): 3–30; Chang-Tai Hsieh and Enrico Moretti, “Housing Constraints and Spatial Misallocation” (NBER Working Paper No. 21154, National Bureau of Economic Research, Cambridge, MA, May 18, 2017).

<sup>12</sup> Sanford Ikeda and Emily Washington, “How Land Use Regulation Undermines Affordable Housing” (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, November 2015); Hsieh and Moretti, “Housing Constraints and Spatial Misallocation”; Jason Furman, “Barriers to Shared Growth: The Case of Land Use Regulation and Economic Rents” (lecture, Urban Institute, Washington, DC, November 20, 2015).

Land and zoning regulations *also* create an incentive for low-skilled workers to stay where housing is cheap, even though the job opportunities there are more limited.<sup>13</sup>

#### OCCUPATIONAL LICENSING

Studies also find that occupational licensing laws raise barriers between workers and better job markets. Under these rules, individuals often must pay high fees, undergo many days in training or experience, earn arbitrary certifications, or do some combination of the three before being allowed to work in a particular state or city.

Today, one-third of US workers are required to comply with occupational licensing requirements, an increase from one-twentieth of US workers in the 1950s.<sup>14</sup> Unlike in the past, when the licensing requirements targeted mostly high-risk and often high-income professions such as surgeon and dentist, poorer individuals now face a larger share of these requirements than before. The requirements are arguably a more meaningful barrier for poorer individuals than for those with more wealth.<sup>15</sup> Many of these occupations, such as hairdresser, transit driver, or skilled technician, traditionally provided low-income Americans with upward mobility and a ladder to self-sufficiency.<sup>16</sup> By effectively restricting access to some jobs, these requirements drive down employment in the licensed industries and make it more difficult for low-income Americans to reach the first rung of that economic ladder, making their climb out of poverty that much more difficult.<sup>17</sup>

Licensing requirements also pose a barrier to interstate mobility, as they vary between states and, with rare exceptions, cannot be transferred. For workers in a licensed industry, moving from one state to another requires costly courses, tests, and training.<sup>18</sup> Even when the tests are the same between states, states often require different scores to pass, making it difficult to transfer licenses.<sup>19</sup> The cost of renewing one's license in a different state creates substantial barriers to entry for many classes of workers, hence limiting interstate mobility.<sup>20</sup>

Occupational licensing also increases the prices of goods and services for consumers. In the case of services such as childcare, this effect is an impediment for working parents wishing to stay attached to the work force.<sup>21</sup>

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<sup>13</sup> Glaeser and Gyourko, "The Economic Implications of Housing Supply"; Peter Ganong and Daniel Shoag, "Why Has Regional Income Convergence in the U.S. Declined?," *Journal of Urban Economics* 102 (2017): 76–90.

<sup>14</sup> Morris M. Kleiner and Alan B. Krueger, "The Prevalence and Effects of Occupational Licensing" (NBER Working Paper No. 14308, National Bureau of Economic Research, Cambridge, MA, September 2008).

<sup>15</sup> About two-thirds of this increase is the result of states adding licensing requirements for a variety of professions. The rest is owing to increased participation in regulated industries. David Schleicher, "The City as a Law and Economic Subject," *University of Illinois Law Review* 2010, no. 5 (September 2010): 1511–12.

<sup>16</sup> Paul J. Larkin Jr., "Public Choice Theory and Occupational Licensing," *Harvard Journal of Law & Public Policy* 38 (January 2015): 209, 212, 216–18, 230.

<sup>17</sup> US Department of the Treasury, Council of Economic Advisers, and Department of Labor, *Occupational Licensing: A Framework for Policymakers*, July, 2015.

<sup>18</sup> Morris M. Kleiner, *Guild-Ridden Labor Markets: The Curious Case of Occupational Licensing* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, January 2015); Dick M. Carpenter II et al., *License To Work: A National Study of Burdens from Occupational Licensing*, 2nd ed. (Arlington, VA: Institute for Justice, November 14, 2017); Morris M. Kleiner, "Border Battles: The Influence of Occupational Licensing on Interstate Migration," *Employment Research* 22, no. 4 (October 2015): 4–6; Morris M. Kleiner, "Reforming Occupational Licensing Policies" (Discussion Paper No. 2015-01, Hamilton Project, Washington, DC, March 2015); Morris M. Kleiner and Alan B. Krueger, "Analyzing the Extent and Influence of Occupational Licensing on the Labor Market" (NBER Working Paper No. 14979, National Bureau of Economic Research, Cambridge, MA, May 2009).

<sup>19</sup> Carolyn Cox and Susan Foster, *The Costs and Benefits of Occupational Licensing* (Washington, DC: Federal Trade Commission, 1990); Morris M. Kleiner, *Licensing Occupations: Ensuring Quality or Restricting Competition?* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, February 2006).

<sup>20</sup> Janna E. Johnson and Morris M. Kleiner, "Is Occupational Licensing a Barrier to Interstate Migration?" (NBER Working Paper No. 24107, National Bureau of Economic Research, Cambridge, MA, December 2017).

<sup>21</sup> Making It More Affordable to Raise a Family, Hearing before the Joint Economic Committee 116th Cong. (2019) (statement of Ryan Bourne, R. Evan Scharf Chair for the Public Understanding of Economics, Cato Institute).

## SOCIAL SECURITY DISABILITY INSURANCE

In recent years economists have been debating why inactivity in the labor force among prime-age men has grown so steadily for so long. The data suggest that the rising inactivity rates may not reflect a worsening of the job market (lower demand), but actually reflect patterns of reduced job seeking (lower supply).<sup>22</sup>

Research by Scott Winship finds that most prime-age men not in the labor force, or inactive, report that they are disabled.<sup>23</sup> The portion of those reportedly disabled men has fluctuated between 56 percent and 65 percent since the early 1990s. Another third of inactive men are retired, enrolled in school or training, or taking care of a family member. Just 1 in 10 men not in the labor force fall outside of these categories. The same study finds that around one-quarter of prime-age inactive men say they want a job, while the remaining three-quarters do not.

Similarly, a report by the Joint Economic Committee finds that almost half of inactive prime-age men are disabled, with poor physical health, poor mental health, or both.<sup>24</sup> The report finds that 25–35 percent of inactive men are retired, in school, or homemakers; and among able-bodied inactive men, only 12 percent say that they want a job when asked. What's more, those who have proactively looked for work in the past year make up 23 percent of inactive men, meaning that three-fourths of inactive prime-age men are not looking for work—many of them because they can't and some of them because they won't. Understanding whether inactive men would prefer to work is important to design policies to stop or reverse the rise in inactivity.

Also, since the increase in the number of prime-age men reporting a disability accounts for roughly half the rise in total inactivity in recent decades, it is useful to look at the possible incentives created by disability programs.

Legislation in 1984 created major reforms to the SSDI program. One of the most consequential changes was to liberalize screening and eligibility for mental health conditions.<sup>25</sup> Over the past 30 years, a growing number of SSDI beneficiaries have qualified for the program not on the basis of having a specific identifiable qualifying condition, but on the basis of their employability given their physical or mental complaint, age, education, and work experience.<sup>26</sup> This has led many scholars to conclude that the changes in SSDI eligibility have increased the number of men claiming disability.<sup>27</sup>

This increase took place even though health improved and most jobs are less physically exerting and dangerous than in the past, with more service jobs and fewer jobs in manufacturing, agriculture, and

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<sup>22</sup> Katharine G. Abraham and Melissa S. Kearney, "Explaining the Decline in the U.S. Employment-to-Population Ratio: A Review of the Evidence" (NBER Working Paper No. 24333, National Bureau of Economic Research, Cambridge, MA, August 2019); Scott Winship, "What's behind Declining Male Labor Force Participation: Fewer Good Jobs or Fewer Men Seeking Them?" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2017).

<sup>23</sup> Winship, "What's Behind Declining Male Labor Force Participation."

<sup>24</sup> "Inactive, Disconnected, and Ailing: A Portrait of Prime-Age Men Out of the Labor Force" (SCP Report No. 2-18, Joint Economic Committee, Washington, DC, September 2018).

<sup>25</sup> David H. Autor and Mark G. Duggan, "The Rise in the Disability Rolls and the Decline in Unemployment," *Quarterly Journal of Economics* 118, no. 1 (2003): 157–206; David H. Autor and Mark Duggan, "The Growth in the Social Security Disability Rolls: A Fiscal Crisis Unfolding" (NBER Working Paper No. 12436, National Bureau of Economic Research, Cambridge, MA, August 2006); Richard V. Burkhauser and Mary C. Daly, *Declining Work and Welfare of People with Disabilities* (Washington, DC: AEI Press, 2011); Mark Duggan, "The Urgency of Reforming Entitlement Programs: The Case of Social Security Disability Insurance," *Issue Brief* 1, no. 8 (August 2013): 1–6.

<sup>26</sup> Burkhauser and Daly, *Declining Work and Welfare*.

<sup>27</sup> "Inactive, Disconnected, and Ailing."

mining.<sup>28</sup> Thanks to medical advances, occupational injury rates have declined, and worker impairments are less severe.<sup>29</sup> All these factors should have reduced the ranks of prime-age men claiming disability.

Winship concludes his study by observing, “The rise in labor force inactivity is primarily a supply-side issue, a reflection of changed incentives for workers on the margin to work less or not at all. But a cause for concern ought to be the rising receipt of disability benefits at a time when a variety of trends point to improved health and greater access to employment among the disabled.”

#### OTHER PROGRAMS

In addition to the limits on access to better job markets, government policies reduce workers’ willingness to exit depressed economic regions in the first place. These policies keep people in stagnant labor markets, limiting output and increasing inequality.<sup>30</sup> Such programs include federal incentives of homeownership.<sup>31</sup> Some studies also find that homeownership rates correlate with substantially higher unemployment and result in substantially lower labor mobility.<sup>32</sup>

Other programs slow the adjustment process. For instance, the Trade Adjustment Assistance program, intended to subsidize US workers affected by import competition, creates disincentives to return to work.<sup>33</sup> Other federal job training programs create similarly negative incentives to return to work. In addition, increases in the real value of state minimum wages can contribute to a decline in aggregate employment rates; as do increases in the share of individuals with prison records.<sup>34</sup>

#### CONCLUSION

Before policymakers rush to implement new federal programs to address worker attachment issues, they should acknowledge that some of the challenges in connecting some workers to the workforce are created by existing government programs. These barriers should be eliminated.

These reforms would lead to more opportunities and better lives for those who have been frozen out of the gains enjoyed by most workers. Unfortunately, in some cases, it isn’t clear what the federal government can do to help move these reforms along, as the issues are caused by state and local government rules. Finally, while these reforms may not be the whole answer to the challenge of connecting more workers to the workforce, a failure to make these changes will make other reform efforts by the federal government less effective or even ineffective.

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<sup>28</sup> Richard W. Johnson, Gordon B. T. Mermin, and Matthew Resseger, “Employment at Older Ages and the Changing Nature of Work” (Report No. 2007-20, AARP, Washington, DC, November 2007); C. Eugene Steuerle, Christopher Spiro, and Richard W. Johnson, “Can Americans Work Longer?” *Straight Talk on Social Security and Retirement Policy*, no. 5 (August 1999): 1-2.

<sup>29</sup> Jagadeesh Gokhale, “SSDI Reform: Promoting Gainful Employment while Preserving Economic Security” (Policy Analysis No. 762, Cato Institute, Washington, DC, October 2014); William J. Wiatrowski, “Occupational Injury and Illness: New Recordkeeping Requirements,” *Monthly Labor Review* (December 2004): 10-24.

<sup>30</sup> Schleicher, “Stuck!”

<sup>31</sup> David Schleicher lists a few of them, such as “the mortgage interest deduction, preferred capital gains tax treatment for housing, mortgage insurance through the Federal Housing Administration and other agencies, the failure to tax imputed rent on owner-occupied housing, secondary market support for mortgages through Fannie Mae and Freddie Mac.” Schleicher, “Stuck!,” 127.

<sup>32</sup> David G. Blanchflower and Andrew J. Oswald, “Does High Home-Ownership Impair the Labor Market?” (NBER Working Paper No. 19079, National Bureau of Economic Research, Cambridge, MA, May 2013).

<sup>33</sup> Paul T. Decker and Walter Corson, “International Trade and Worker Displacement: Evaluation of the Trade Adjustment Assistance Program,” *Industrial and Labor Relations Review* 48, no. 4 (1995): 758-74; Leah H. Marcal, “Does Trade Adjustment Assistance Help Trade-Displaced Workers?,” *Contemporary Economic Policy* 19, no. 1 (2001): 59-72; Sarah Dolfin and Peter Z. Schochet, *The Benefits and Costs of the Trade Adjustment Assistance (TAA) Program under the 2002 Amendments* (Princeton, NJ: Mathematica Policy Research, December 2012), 57.

<sup>34</sup> Abraham and Kearney, “Explaining the Decline in the U.S. Employment-to-Population Ratio.”