ISSUES 2012 | No. 6 March 2012

MANHATTAN INSTITUTE FOR POLICY RESEARCH

HOW OBAMACARE INCREASES UNEMPLOYMENT

Diana Furchtgott-Roth
Senior Fellow

High unemployment rates are at the top of the list of concerns for American workers. In early March, the Labor Department announced that the unemployment rate held steady at 8.3 percent. The rate has remained above 8 percent for over three years.

Even though an 8.3 percent rate of unemployment is high, it masks a broader employment problem in the workforce. Including discouraged and underemployed workers, the Labor Department's measure of unemployment is 14.9 percent. And many workers have left the labor force because they have not been able to find jobs. The labor force participation rate has declined from 66 percent in January 2009 to 64.9 percent today—a rate that is about equal to the early 1980s.

The mandated $2,000 per worker tax in the new health care law, effective 2014 and levied on employers who do not provide the right kind of health insurance, is discouraging hiring. The Patient Protection and Affordable Care Act of 2010 will raise the cost of employment when fully implemented in 2014. Companies with 50 or more workers will be required to offer a generous health insurance package, with no lifetime caps and no copayments for routine visits, or pay an annual penalty of $2,000 for each full-time worker. Moving from 49 to 50 workers will cost a firm $40,000 a year.

Employers see these penalties coming, and they are adjusting their workforces accordingly. The evidence that employers are economizing on workers is all around us. More supermarkets and drug stores have self-

Published by the Manhattan Institute

scanning machines at checkout. Large department stores have price-scanning machines scattered around the stores, so that shoppers can check prices without asking a clerk. Food trucks line the streets in New York and Washington, D.C., enabling restaurants to sell their food without waiters. These workforce adjustments are just one reason that employment growth has been slower than usual during this economic "recovery."

Hardest hit are workers with fewer jobs skills. The unemployment rate for adult workers with less than a high school diploma is 12.9 percent. Teens face an unemployment rate of 23.8 percent. The rate for African American teens is even higher, at 34.7 percent.

Another group that is disproportionately affected is younger workers. Of the 2 million adults who found jobs over the past year, 1.7 million are over 55 years old, and 300,000 are between 25 and 55—even though the 25 to 55 group is three times the size of those 55 and older. Younger workers have far fewer employment opportunities, which affects their lifetime expected earnings.

The $2,000 per worker penalty raises significantly the cost of employing full-time workers, especially low-skill workers, because the penalty is a higher proportion of their compensation than for high-skill workers, and employers cannot take the penalty out of employee compensation packages.

Suppose that a firm with 49 employees does not provide health benefits. Hiring one more worker will trigger a penalty of $2,000 per worker multiplied by the entire workforce, after subtracting the statutory exemption for the first 30 workers. In this case the tax would be $40,000, or $2,000 times 20 (50 minus 30). Indeed, a firm in this situation might have a strong incentive not to hire a 50th worker, or to pay him off the books, thereby violating the law.

In addition, if an employer offers insurance, but an employee qualifies for subsidies under the new health care exchanges because the insurance premium exceeds 9.5 percent of his income, his employer pays a penalty of $3,000 per worker. This combination of penalties gives a business a powerful incentive to downsize, replace full-time employees with part-timers, and contract out work to other firms or individuals.

The new law will make it harder for small businesses with 50 or more employees to compete with those with fewer than 50 employees.

When the employer mandates are phased in 2014, many businesses will be motivated to reduce the number of locations and move workers from full-time to part-time status. This will reduce employment still further and curtail the country's economic growth.

Industries that have traditionally offered the greatest opportunities to entry-level workers—leisure and hospitality, restaurants—will be particularly hard-hit by the new law. Many of these employers do not now offer health insurance to all of their employees, and employ large percentages of entry-level workers, whose cost of hiring will increase significantly.

Under the new law, for each block of 30 weekly hours of part-time work by one or more employees a business is deemed to have one full-time equivalent employee. The penalty for full-time employees is $2,000 per worker after the first 30 employees.

Businesses with fewer than 50 employees will be the big winners. If they do not hire too many workers—another government-induced disincentive for hiring in this weak labor market—and stay within the 49-person limit, these firms will not have to provide health insurance and will have a cost advantage over the others. Such businesses will be able to compete advantageously against businesses with multiple locations and 50 or more employees.

The $2,000 tax will amount to 15 percent of average annual earnings in the food and beverage industry and 9 percent in retail trade. This is a cost in addition to the employer's share of Social Security and Medicare taxes (7.65 percent, equal to what the employee pays), as well as workers' compensation and unemployment insurance.

When government requires firms to offer benefits, employers will generally prefer to hire part-time

Table I: Disincentives for Growth

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Full-Time Employees*	49	50	75	100	150
2014 Penalty	$0	$40,000	$90,000	$140,000	$240,000
Change in Cost per Employee (2014)	$0	$800	$1,200	$1,400	$1,600
Percent Cost Increase per Employee (2014)	0.0%	2.0%	3.0%	3.5%	4.0%

Source: Author calculations based on new health care law.
Note: Scenario 1 assumes that there are no part-time employees and therefore the employer mandate does not apply.
* Avg. Annual Wage $40,000

Table 2: Cost Savings from Moving Workers from Full-time to Part-time

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5	Scenario 6
Full-time Employees	85,000	68,000	51,000	34,000	17,000	0
Part-time Hourly Employees	7,000	28,250	49,500	70,750	92,000	113,250
2014 Employer Mandate Penalty	$169,940,000	$135,940,000	$101,940,000	$67,940,000	$33,940,000	0
Change in Total Cost (2014)	$169,940,000	-$113,593,500	-$397,135,500	-$680,653,000	-$964,231,000	- $1,247,679,750
Percent Change in Cost per Employee	6.64%	-8.66%	-22.67%	-35.55%	-47.42%	-58.40%
Assumed Cost per Labor Hour (2011)	$19.60	$19.60	$19.60	$19.60	$19.60	$19.60
Cost per Labor Hour (2014)	$20.91	$18.73	$16.56	$14.39	$12.21	$10.04

Source: Author calculations based on new health care law.
Note: The calculation is full-time employees minus the exempted 30 full-time employees, and then multiplied by the $2,000 employer mandate penalty.

workers, who will not be subject to the penalty. Even though the Affordable Care Act counts part-time workers by aggregating their hours to determine the size of a firm, part-time workers are not subject to the $2,000 penalty. Hence, there will be fewer opportunities open for full-time work. Many workers who prefer to work full-time will have an even harder time finding jobs.

In January 2012 over 8 million people were working part-time because they could not find full-time jobs. The new health care law would exacerbate this problem.

In addition to hiring more part-time workers, firms will have an added incentive to become more automated, or machinery-intensive—and employ fewer workers. Fast food restaurants could ship in more precooked food and reheat it, rather than cook it on the premises. Something analogous is already gaining momentum in industries such as DVD rental, where manual labor at retail outlets is being replaced by customer-activated DVD checkout. Supermarkets, drugstores, and large-chain hardware stores also are introducing do-it-yourself customer checkout.

The law, as written, allows some employers to keep existing plans, a term known as "grandfathering." However, restrictions on "grandfathering" in subsequent regulations issued by the Department of Health and Human Services could force up to 80 percent of small businesses to drop their current health insurance plans within three years. They will either replace them with more expensive new plans, or go without insurance altogether and pay the tax, according to the government estimates.[1]

The restaurant industry provides an example of how firms with seasonal, part-time employees, competitive environments, and low profit margins will face new challenges in connection with the provision of health insurance. Some restaurant owners are likely to drop existing coverage that no longer meets the requirements of the Act. Several restaurants received waivers from the Department of Health and Human Services in 2011, but these waivers will not continue into 2014, once the Act is fully phased in. Many restaurants will be penalized because their low-wage workers will choose to get subsidized coverage on the state exchanges.

The disincentive in the Act to hire additional workers is illustrated in Table 1. If a business does not offer health insurance, then, beginning 2014, it will be subject to a tax if it employs more than 49 workers in all its establishments. For 49 workers, the tax is zero. For 50 workers, the tax is $40,000; for 75 workers, it is $90,000; and for 150 workers, the tax is $240,000. Each time a business adds another employee, the tax rises.

On the other hand, as is shown in Table 2, businesses can reduce costs by hiring part-time workers instead of full-time workers. A firm with 85,000 full-time workers and 7,000 part-time workers that does not offer health insurance would pay a tax of $170 million. By keeping the number of hours worked the same, and gradually reducing full-time workers and increasing part-time workers, until the firm reaches 17,000 full-time workers and 92,000 part-time workers, the tax is reduced to $34 million. If the firm abandons full-time workers altogether, admittedly an unlikely option, but useful for illustration, the tax is reduced to zero.

Some businesses could minimize cost by increasing part-time hourly workers, reducing the number of full-time workers, and dropping employer-provided health insurance. Even if businesses choose to offer health insurance to their full-time employees, the Act gives them an incentive to employ more part-time hourly workers than full-time workers in an effort to maximize tax benefits. If Congress leaves these incentives in place, the reduction in full-time employment would be costly to the economy.

With unemployment above 8 percent, it is worth examining the effects of penalties on employment under the new health care law. America cannot afford these negative effects on employment.

ENDNOTE

[1] U.S. Department of the Treasury, U.S. Department of Labor, U.S. Department of Health and Human Services, "Interim Final Rules for Group Health Plans and Health Insurance Coverage Relating to Status as a Grandfathered Health Plan Under the Patient Protection and Affordable Care Act, *Federal Register*, Vol. 75, No. 116, Thursday, June 17, 2010.