

Employee Benefits and Labor Markets in Canada and the United States

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Chapter 1 - Introduction

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Some of the most important personal consumption items that individuals receive are closely tied to work and are provided or financed by employers, either voluntarily or by government mandate. In the United States and Canada, as in most industrialized countries, these benefits include retirement income, health care, income during times of unemployment (in the form of unemployment insurance), income and medical care in the event of workplace injury (workers' compensation), and life insurance. Employers' expenditures on these employee benefits have grown dramatically in the last 50 years and now are on the order of one-third of total labor costs in most industrialized countries (Hart et al. 1988).

This volume brings together 14 original research chapters on various aspects of the employee benefits systems of Canada and the United States. Preliminary versions of some of the papers in the volume were presented at a conference held in the mid 1990s sponsored and supported by the William H. Donner Foundation and the W.E. Upjohn Institute for Employment Research. In planning the volume, our intention has been to use a Canadian-U.S. comparison to highlight the basic economic features of employee benefits and the policy issues that are connected with them.

There are substantial differences between the employee benefit systems of Canada and the United States; the most striking are in the two countries' health care systems. In Canada, health care is provided through a system of provincial and territorial plans funded by the federal government out of general revenues, whereas in the United States health care is provided through a mixed private/public system financed largely by employer contributions and payroll taxes. Because the Canadian provincial and territorial plans are funded out of general revenues, they are not perceived as an employer cost, as they are in the United States.

The differences between Canada and the United States in other social insurance programs are less stark, although the differences are nonetheless substantial. For example, government involvement in the provision of retirement income takes the form of three major programs in Canada, as opposed to just one in the United States. Public pensions are more generous and private pension plans are correspondingly less important in Canada than in the United States (see the chapters by Gunderson, Hyatt, and Pesando (p. 381) and by Dorsey (p. 413) in this volume).

The existence and magnitude of employee benefits pose numerous economic questions that are important to public policy. In organizing the volume, we have grouped these questions under four headings: labor supply and worker availability, labor demand, labor-market adjustment and equity, and pensions. We place issues such as whether the availability of benefits (or lack thereof) create incentives or disincentives to work under the heading of labor supply, treated in Part I. (To some extent, these issues are also treated

in chapters on labor-market adjustment. For example, the chapters by Olson (p. 295) and by Hunt-McCool, McCool, and Dor (p. 325) address the labor-supply implications of the U.S. health care system, which essentially requires an individual to work in order to be covered by health insurance.) Issues stemming from the status of employee benefits as a cost of labor (do employee benefits create incentives that alter the level or mix of employment?) are labor-demand issues, treated in Part II. The potential for employee benefits to affect worker turnover, tenure, and wages are adjustment issues, treated in Part III. Finally, Part IV centers on issues related to retirement income programs, both public and private.

Differences between the United States and Canada in employee benefits and labor costs offer a natural laboratory in which to examine the impacts of differing policies on labor market outcomes in the two countries. In both the United States and Canada, however, there is a dearth of research that is both rigorous and policy-relevant on the linkages between labor markets and the provision of these benefits by employers or the government. We hope that the research presented in this volume helps fill the gap.

CHAPTER SUMMARIES

In his overview chapter, (“Does the Composition of Pay Matter?”), Sherwin Rosen addresses an essential question and places the issues posed by employee benefits in their proper economic context. Rosen views employment-related benefits as consumption decisions that have been centralized so as to become collective or group decisions, delegated partly to firms and partly to governments. He offers three economic reasons for the centralization of certain consumption decisions. First, there may be economies of scale in the provision of some goods; that is, joint provision of a common good may reduce transaction and other costs that would be incurred if decisions were made individually. Rosen notes that such economies take on special importance as a motive for employer-provided benefits when certain benefits escape taxation. Second, some goods may be viewed as inputs that enhance productivity—hence, firms paternalistically provide some goods to improve their workers’ welfare and productivity. Similarly, enduring employment relationships and employment security may be viewed and analyzed in light of their effects on workers’ productivity. Third, and insurance rationale—or an intertemporal consistency problem, as Rosen calls it—motivates many employee benefit programs. Rosen emphasizes the moral hazard that social provision of health, retirement, and other benefits may produce and discusses the principle that public provision of such benefits may merely offset or substitute for their private provision. Rosen applies these three analytical insights in discussions of military compensation and of compensation in the former Soviet Union. Overall, Rosen’s sweeping and comprehensive essay offers a framework for future economic research on employee benefits.

Part I of the volume comprises three chapters that treat the relationship between employee benefits and the supply of labor.

In Chapter 1 (“Child Care and the Supply of Labor in Canada and the United States”), Charles Michalopoulos and Philip Robbins address differences between Canada and the United States in child-care arrangements and the working patterns of women. The growth of the labor-force participation rate of married women had been accompanied by the growing use of day-care centers and caregivers who are not family relatives and the declining use of parental care and family relatives. Significant controversy has surrounded the extent to which the child-care choices and labor-force decisions of women are affected by government policies that subsidize child care. Michalopoulos and Robbins analyze pooled Canadian and U.S.

data with the goal of obtaining improved estimates of the effect of subsidies on child-care choices and labor supply of mothers. They describe the broad similarities and specific differences between the two countries' child-care policies (both countries provide general and targeted child-care subsidies through their personal income tax systems) and present data describing the methods of child care in each country. They then estimate the impact of child-care prices and subsidies on both the primary form of child care used by families and the labor-force behavior of mothers. The authors' empirical results suggest that the form of child care chosen and employment of the mother are influenced mainly by the husband's earnings, ethnicity, and location. There is little evidence that child-care prices and subsidies influence the form of child care in the two countries. Neither do child-care prices and subsidies appear to be major determinants of whether mothers work full time, part time, or not at all.

In Chapter 2 (“An Economic Model of Employee Benefits and Labor Supply: An Application of the Almost Ideal Demand System”), Paul Fronstin turns to an essential question that has rarely been addressed in empirical research: Does the mix of compensation influence labor supply and, if so, how? He addresses this question by estimating a system of demand equations for leisure and employee benefits using data from the 1993 Current Population Survey. His estimation proceeds in two stages. In the first stage, he estimates a bivariate probit model of labor supply (the probability of working) and employee benefits (the probability of participating in a salary-reduction pension plan). In the second stage, he estimates selectivity-corrected share equations for leisure and pension contributions. The central (and novel) result in Fronstin's chapter is his estimate of the cross-price elasticity between leisure and pension contributions, which he finds is essentially zero; that is, pensions, unlike wages, have minimal effect on the supply of labor. Fronstin's other results of estimation are in keeping with existing empirical findings; for example, he finds that pensions and wages are highly substitutable. Although limited by the unavailability of data on other aspects of compensation, Fronstin's innovative study points the way to further exploration of the relationship between labor supply and employee benefits when improved data do become available.

As the labor-force participation of women has grown, so has the importance of family and medical leave benefits. In chapter 3 (“The Economics of Family and Medical Leave in Canada and the United States”), Eileen Trzcinski and William T. Alpert provide a description of the family and medical leave policies of both Canada and the United States, noting that family and medical leave provisions have (potentially) two components - the provision for wage replacement benefits during the leave and the guarantee of the same or similar job upon return from the leave. In Canada, each province mandates family and medical leave that includes both wage replacement and a job guarantee, whereas in the United States, the Family and Medical Leave Act (FMLA) of 1993 provides only a job guarantee, and this only in firms with 50 or more workers. Trzcinski and Alpert used data on more than 2,700 firms from the 1988 Small Business Administration's Employee Leave Survey to describe the incidence of family leave policies in the United States before enactment of the FMLA. They use the same data to model the determinants of each of the main components of family and medical leave—paid leave and a job guarantee. Their modeling efforts are more successful in tracing the factors that are correlated with paid leave provision than the factors that are correlated with a job guarantee upon return from a leave. They interpret their results to suggest that different theoretical approaches are needed to understand the incidence of paid leave and a job guarantee and to predict the impacts of further legislative mandates.

Part II of the volume turns to an examination of the relationship between employee benefits and the demand for labor. Payroll taxes are used to finance all three of the major social insurance programs in the

United States: Social Security, workers' compensation, and unemployment insurance. The most persistent criticism facing social insurance programs financed by employer contributions has been that they raise labor costs and thereby reduce both employment and the competitiveness of U.S. business. In Chapter 4 ("Payroll Taxation, Employer Mandates, and the Labor Market: Theory, Evidence, and Unanswered Questions"), Jonathan Gruber appraises this and other criticisms of mandated employer contributions in the United States. Gruber reviews programs that are financed by payroll taxes and discusses the theory and evidence on the labor market effects of payroll taxes and employer mandates (including various complications such as minimum wages and group-specific mandates). He also presents some new evidence on the influence of employer mandates on wages at both the individual and firm levels. He then considers the implications for efficiency and equity for changing the method of financing social insurance programs from the payroll tax to the income tax. This highly useful chapter highlights what is known about the labor-market effects of payroll taxation and employer mandates, develops and presents new evidence, and points the way to fruitful avenues for further research.

In Chapter 5, Masanori Hashimoto continues this line of inquiry with a theoretical treatment of the relationship between employee benefits and labor demand ("Fringe Benefits and Employment"). Hashimoto's model differs from previous models of employee benefits by considering the entire market for benefits rather than focusing solely on the decisions of firms. In this setting, changes in employee benefits can occur because workers' tastes for benefits change, because the cost of providing benefits changes, or because of changes in government mandates. Whether increases in employee benefits reduce employment, then, depends on the cause of the increase in benefits. Increases in benefits that follow from reduced benefit costs or from increased demand for benefits by workers (resulting from favorable tax treatment, for example) will increase employment. Increases in benefits that follow from increased government mandates, on the other hand, are likely to lead to employment losses. Hashimoto also reports the results of some sensitivity tests of his model's results,

Part III of the volume includes four chapters that consider the implications of employee benefits for worker turnover, wages, and equity. The first three chapters in Part III focus mainly on a peculiar feature of health insurance provision in the United States—that most individuals who are covered by private health insurance are covered through an employer-provided plan and that employer-provided health insurance often covers all members of a worker's family. It stands to reason that this link between the job and the availability of health insurance could affect the behavior of workers in a variety of ways.

In Chapter 6 ("Family Health Benefits and Worker Turnover"), Dan Black examines a previously unexplored aspect of the link between health benefits and turnover. Although much attention has focused on so-called preexisting conditions clauses as a source of "job lock," Black notes that the family coverage provisions of many employer-provided health insurance plans are even more likely avenue by which employer-provided health insurance could affect worker turnover. Black's theoretical treatment shows that the existence of employer-provided family health coverage can alter the value that a worker places on alternative job offers, increasing or decreasing the likelihood of turnover depending on specific circumstances. Black then uses April 1993 Current Population Survey (CPS) data to document the extent of double coverage by employer-provided health insurance. As a test of his theory, he uses the same data to estimate models (for men and women) of job change in which the probability of recent job change depends on coverage by a spouse's health insurance plan (among other variables). Black finds that workers (both men and women) who are covered by the employer-provided health insurance of their spouses are

about 50 percent more likely than others to have changed jobs in the last year, suggesting in turn that the existence of employer-provided spousal benefits substantially distorts incentives to change jobs and reduces the efficiency of labor markets.

In Chapter 7 (“Part-Time Work, Health Insurance Coverage, and the Wages of Married Women”), Craig Olson examines whether employer-provided health insurance influences the labor-supply decisions and wages of married women. Using CPS data from 1983 and 1993, he first shows that women who are married to men without health-insurance coverage are more likely to have jobs that provide health insurance than are women married to men who do have health insurance coverage. In other words, wives whose husbands do not provide health insurance have a higher demand for health insurance than wives whose husbands do provide health insurance. In turn, married women who are not covered by their husband’s health insurance may increase their work hours in order to obtain health insurance coverage at work (part-time jobs are less likely than full-time jobs to offer health insurance). Olson’s empirical results using 1993 data support this notion: in contrast, his results for 1983 show no impact of husbands’ health insurance coverage on wives’ work hours. Olson argues that this change was caused by the decline in health insurance coverage among men during the 1980s; that is, as health insurance coverage among men fell, more women increased their work hours to gain eligibility for employer-provided benefits.

In Chapter 8 (“Employer-Provided versus Publicly Provided Health Insurance: Effects on Hours Worked and Compensation”), Janet Hunt-McCool, Thomas McCool, and Avi Dor further examine the impact of employment-based health insurance on labor-market behavior and outcomes. In particular, they examine differences in the behavior of married women who are and are not covered by the employer-provided health insurance of their husbands. They view women who are covered by their husbands’ health insurance as “virtual Canadians,” in that their decisions about labor-force participation and labor supply are independent of employers’ health insurance offers (as is the case under a system of public health care like Canada’s). On the other hand, women who are not covered by their husbands’ health insurance are likely to consider employers’ health insurance offers in making labor-supply decisions. Using data from the 1987 National Medical Expenditure Survey, they estimate two-stage models of wages, earnings, compensation, and health insurance premiums (the first stage of their models creates controls for possible selection in the matching of women to men who do or do not have jobs that provide family health benefits). Their results are consistent with two hypotheses: 1) women who are not covered by their husbands’ health insurance select jobs that provide health insurance and 2) these women are willing to sacrifice wage income for health insurance. Hunt-McCool, McCool, and Dor, like Black, suggest that efficiency and social welfare are reduced by the U.S. system of providing health care provision.

As employee benefits have grown as a share of total compensation, their potential to have important implications for the distribution of income has also grown. Few studies of income distribution, however, have considered employee benefits. In Chapter 9 (“Employee Benefits and the Distribution of Income and Wealth”), Daniel Slottje, Stephen Woodbury, and Rod Anderson examine household data that include information on health insurance expenditures (the National Medical Care Expenditure Survey and the National Medical Expenditure Survey) or pension wealth (the 1983 and 1989 Surveys of Consumer Finances) in an effort to better understand how employee benefits influence income distribution. They find that employer contributions to health insurance, although more unequally distributed than personal income, are distributed in such a way that they slightly reduce the overall distribution of income. They find that the distribution of private pension wealth is about unequal as the distribution of private nonretirement wealth

overall, although private pensions smooth the high end of the wealth distribution. These findings suggest that neither health insurance programs nor private pensions can be seen as a major force behind increasing inequality in the distribution of income or wealth.

Part IV of the volume comprises four chapters that focus on pensions and public policy toward retirement income in Canada and the United States. In Chapter 10 (“Public Pension Plans in the United States and Canada”), Morley Gunderson, Douglas Hyatt, and James Pesando offer a highly useful analytical description and comparison of the government programs that provide retirement income in Canada and the United States. They compare the contributions to and benefits from both public and private pensions, discuss the extent to which public pensions replace earnings, and examine how public pensions transfer income both within and between generations. The authors also treat the potential effects of the Canadian and U.S. public pension plans on work incentives, retirement, and the demand for labor. The authors’ emphasis on comparing the Canadian and U.S. systems brings into relief the essential features of any public retirement system and highlights the problems facing any government program that provides retirement income.

Whereas Gunderson, Hyatt, and Pesando focus on public pensions, Stuart Dorsey describes and reviews the literature on private pensions in Canada and the United States in Chapter 11 (“Current Policy Issues Toward Private Pensions in Canada and the United States”). He begins with a brief review of the history of private pensions in Canada and the United States, then describes and compares the main features of government intervention into private pensions - tax policy and regulation - which are remarkably similar in the two countries. The bulk of Dorsey’s chapter is devoted to discussing four specific policy issues that confront both Canada and the United States in considering the future of private pensions: the extent of private pension coverage, the portability of private pensions, tax policy toward private pensions, and the problem of indexing pension benefits for inflation. In all of these discussions, Dorsey highlights the results of research and the relevance of research to policy toward private pensions.

In Chapter 12 (“Labor-Market Effects of Canadian and U.S. Pension Tax Policy”), James Pesando and John Turner examine a special feature of pension policy in both Canada and the United States: the tax-favored treatment of employer contributions to pension plans. Neither in Canada nor in the United States are employer contributions to private pensions subject to the personal income tax, creating an incentive for workers to receive compensation in the form of contributions to a private pension plan. Pesando and Turner’s main goal is to trace the influence of this favorable tax treatment on the extent of pension coverage. In addition, they examine how the tax treatment of pensions affects three other outcomes: the generosity of pension plans, whether private pension plans are funded through employer or worker contributions, and whether pensions take the form of defined-benefit or defined-contribution plans. The authors pay special attention to two important differences between Canada and the United States. First, worker contributions to private pension plans in Canada are tax deductible regardless of whether the worker participates in a defined-benefit or a defined-contribution plan, whereas a worker in the United States must participate in a 401k (or similar) plan for his or her contributions to be tax deductible. Second, in Canada, workers face a lower limit on the amount they can save through the pension system.

The volume closes with an empirical analysis of a worrisome trend—the decline in private pension coverage that occurred among young men during the 1980s. In Chapter 13 (“Did the Decline in Marginal Tax Rates during the 1980s Reduce Pension Coverage?”), Patricia Reagan and John Turner use Current

Population Survey data from 1979, 1988, and 1993 to examine the reasons for this decline. Their analysis stems from the reasoning that, because employer contributions to private pensions are not subject to the personal income tax, the incentive for workers to be covered by pensions (and to receive compensation in the form of contributions to a private pension plan) rises as the marginal personal income tax rises. Reagan and Turner's careful modeling efforts suggest that a 1-percentage-point increase in the marginal income tax rate leads to a 0.4 percentage-point increase in pension coverage rates. It follows that the drop in marginal tax rates that occurred during the 1980s was an important factor in the reduced pension coverage of young men.

Reference

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