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Public Interest Comment¹ on the Department of Labor's Proposed Rule:

Establishing a Minimum Wage for Contractors

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The George Washington University Regulatory Studies Center

Retrospective Review Comment Project

The George Washington University Regulatory Studies Center strives to improve regulatory policy through research, education, and outreach. As part of its mission, the Center conducts careful and independent analyses to assess rulemaking proposals from the perspective of the public interest. This comment on the Department of Labor's proposed rule implementing Executive Order 13658, Establishing a Minimum Wage for Contractors, does not represent the views of any particular affected party or special interest, but is designed to evaluate whether DOL's proposal incorporates plans for retrospective review, pursuant to Executive Order 13563.

Introduction

The notice of proposed rulemaking ("NPRM") establishes standards and procedures for implementing Executive Order 13658 ("the EO"), which raises the wages of federal contractors

¹ This comment reflects the views of the author, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at <http://research.columbian.gwu.edu/regulatorystudies/research/integrity>.

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to \$10.10 per hour beginning January 1, 2015.³ The NPRM additionally proposes a \$4.90 per hour wage for tipped workers, which will increase until it reaches seventy percent of the proposed wage under Section 2 of EO 13658 (“Section 2”). The NPRM implements the EO by setting forth the general minimum wage requirement for contractors, creating an anti-retaliation provision, and prohibiting any waiver of rights by contractors.⁴ The remainder of the rule outlines compliance obligations for the Department of Labor (DOL or “the Department”) and contracting agencies and then specifies administrative enforcement proceedings.

The NPRM defines several terms; notably “minimum wage,” “tipped employee,” and “contractor” are characterized for the purpose of compliance with and enforcement of the EO. The Department goes on to define *Executive Order minimum wage* as a wage that is \$10.10 per hour starting January 1, 2015; and beginning January 1, 2016, (and annually afterwards), an amount determined by the Secretary of Labor (“Secretary”).⁵ The NPRM “strongly encourages,” but does not compel, independent agencies to comply with its requirements. However, private entities that lease Federal property are subject to the NPRM, such as fast food restaurants in highway rest stops. Similarly, contracted firms such as barber shops and credit unions which operate in Federal buildings will be subject to these requirements.⁶

According to the NPRM in concurrence with Section 2, tipped employees initially receive an hourly wage of \$4.90 per hour beginning January 1, 2015 which increases thereafter annually. The limit the tipped wage can reach is seventy percent of the wage determined annually by the Secretary. The hourly wage for tipped workers will increase by the lesser of \$0.95 or the amount necessary for the wage to reach seventy percent of the determined wage, rounded to the nearest \$0.05. If the tipped workers do not receive enough in form of tips to satisfy the established wage, employers must cover the remaining deficit. However, if an existing law or regulation (such as the Service Contract Act) requires a higher wage under such circumstances, the applicable regulation or law will require the employer to pay the higher wage.

The purpose of this rule stems from the Federal Government’s declared interest in economic efficiency - which purportedly is promoted when the Federal Government contracts with sources that “adequately compensate their workers.”⁷ In the EO, President Obama asserts,

Raising the pay of low-wage workers increases their morale and the productivity and quality of their work, lowers turnover and its accompanying costs, and

³ 79 FR 34570

⁴ 79 FR 34570

⁵ 79 FR 34572

⁶ 79 FR 34576

⁷ 79 FR 34570

reduces supervisory costs. These savings and quality improvements will lead to improved economy and efficiency in Government procurement.⁸

The Department uses these reasons to support the NPRM's conclusions of cost saving and quality improvement in contracted work performance; stating that taxpayers will receive more value from the Federal Government's investments.

As a part of its ongoing Retrospective Review Comment Project, the Regulatory Studies Center examines significant proposed regulations to assess whether agencies propose retrospective review as a part of their regulations, and submits comments to provide suggestions on how best to incorporate plans for retrospective review into their proposals. To facilitate meaningful retrospective review after the promulgation of a final rule, multiple government guidelines instruct agencies to incorporate retrospective review plans into their proposals during the rulemaking process.

Incorporating Retrospective Review into NPRMs

Through a series of Executive Orders, President Obama has encouraged federal regulatory agencies to review existing regulations "that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned." On January 18, 2011, President Obama signed Executive Order 13563, Improving Regulation and Regulatory Review, which reaffirmed the regulatory principles and structures outlined in EO 12866. In addition to the regulatory philosophy laid out in EO 12866, EO 13563 instructs agencies to

consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned. Such retrospective analyses, including supporting data, should be released online whenever possible.⁹

This ex-post review makes it possible for the government and the public to measure whether a particular rule has had its intended effect. In his implementing memo on retrospective review, former Administrator of the Office of Information and Regulatory Affairs, Cass Sunstein, stated the importance of designing regulations to facilitate their evaluation:

With its emphasis on "periodic review of existing significant regulations," Executive Order 13563 recognizes the importance of maintaining a consistent

⁸ 79 FR 9851

⁹ Exec. Order No. 13563, *Improving Regulation and Regulatory Review*, 76 FR 3821 (2011).

culture of retrospective review and analysis throughout the executive branch. To promote that culture, *future regulations should be designed and written in ways that facilitate evaluation of their consequences* and thus promote retrospective analyses and measurement of “actual results.” To the extent permitted by law, agencies should therefore give careful consideration to how best to promote empirical testing of the effects of rules both in advance and retrospectively.¹⁰ [Emphasis added]

This emphasis is repeated in Sunstein’s June 14, 2011 memo, “Final Plans for Retrospective Analysis of Existing Rules.” In its 2013 Report to Congress on the Benefits and Costs of Federal Regulations, the Office of Management and Budget (OMB) states that such retrospective analysis can serve as an important corrective mechanism to the flaws of ex ante analyses. According to that report, the result of systematic retrospective review of regulations:

should be a greatly improved understanding of the accuracy of prospective analyses, as well as corrections to rules as a result of ex post evaluations. A large priority is the development of methods (perhaps including not merely before-and-after accounts but also randomized trials, to the extent feasible and consistent with law) to obtain a clear sense of the effects of rules. In addition, and importantly, *rules should be written and designed, in advance, so as to facilitate retrospective analysis of their effects.*

In the NPRM the Department references both Executive Orders 12866 and 13563, but only with respect to their ex ante regulatory analysis requirements. There is no explicit mention of conducting retrospective review.

Retrospective Review Requirements

To evaluate whether DOL’s proposal was “designed and written in ways that facilitate evaluation of [its] consequences,” we measure it against five criteria:

- Did DOL clearly identify the problem that its proposed rule is intended to solve?
- Did DOL provide clear, measurable metrics that reviewers can use to evaluate whether the regulation achieves its policy goals?
- Did DOL commit to collecting information to assess whether its measureable metrics are being reached?

¹⁰ United States. Office of Management and Budget. Office of Information and Regulatory Affairs. *MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES: Retrospective Analysis of Existing Significant Regulations*. By Cass Sunstein. April 25, 2011.

- Did DOL provide a clear timeframe for the accomplishment of its stated metrics and the collection of information to support its findings?
- Did DOL write its proposal to allow measurement of both outputs and outcomes to enable review of whether the standards directly result in the outcomes that DOL intends?

Identifying the Problem

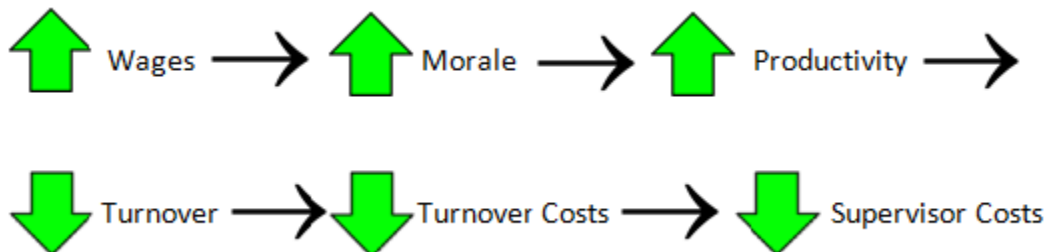
The first of the “Principles of Regulation” outlined by President Clinton in Executive Order 12866 makes it clear that, as a first step, agencies must be able to identify the problem that justifies government action through regulation:

Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem.

This step is crucial to the formulation of any policy. Without knowledge of the problem that the agency is trying to address, the public cannot assess whether the policy or regulation at hand has had the intended effect, which is key in retrospectively evaluating regulation.

Pursuant to Executive Order 13658, the NPRM seeks to raise the minimum wage to \$10.10 per hour for all federal contractors in order to increase efficiency and cost savings. This increase is intended to boost worker morale, productivity, and work quality, reduce worker turnover and associated costs and supervisory costs. The Executive Order also asserts that this minimum wage will bolster the economy and improve efficiency in government procurement.

The NPRM does not directly address a market failure, but instead relies on the reasons the EO promotes as justification for the rule, namely, “The Order therefore seeks to increase efficiency and cost savings in the work performed by parties that contract with the Federal Government by raising the hourly minimum wage...”¹¹ The NPRM follows the same logic presented in the Executive Order, which can be summed up in the following chart:



¹¹ 79 FR 34568

To evaluate the premise of the EO and NPRM, we must assess the validity of the above implied causal chain. Measuring the first two linkages (that higher wages improve worker morale and that that better morale results in greater productivity), will be challenging. The efficient wage theory suggests employers pay their workers more to increase productivity and motivation.¹² The logic above appears to follow such a theory. However, generally when wages increase, that is a result of an employer rewarding productive labor and/or collective bargaining. Thus, the productivity may cause the wage increase, rather than the other way around. To validate the assumptions implicit in the proposal, DOL should develop plans to measure the linkages between federally-mandated minimum wages, morale, and productivity. Through the NPRM, the minimum wage increase seeks to replicate results observed in private labor markets,¹³ but a mandatory wage increase, without other factors associated with such wage changes, may not lead to the predicted growth in productivity.

As DOL implements the EO, it should conduct studies on low-income individuals in the private market as well as with people affected by the public-private contracting minimum wage increase. It should not only examine the relationship between higher wages and productivity and morale, but consider potential correlation-causation biases. Moreover, DOL should measure the linkage between efficient wages paid voluntarily by employers and the mandatory nature of the Executive Order. The source of the wage increase will likely have ancillary consequences. Scrutinizing the source of the wage increase will likely provide insight regarding how to best measure to what extent worker morale, productivity, turnover, and supervisory costs change.

While morale may not be directly measurable, productivity, turnover, and supervisory costs are, and DOL should commit to measuring them. Bureau of Labor Statistics data should be valuable for this purpose.¹⁴ This information would likely influence DOL's interpretation of changing supervisory costs too.

Economic Analysis and Methodology

In the proposed rule, the Department found that no single data source contained information on how many federal contract workers receive wages below \$10.10, so it compiled data from multiple outlets. The rule's analysis is based on data from the Principal North American Industry Classification System ("NAICS") to identify industries likely to employ workers covered by the EO and the Current Population Survey ("CPS") to estimate the number of workers within a state applicable to NAICS categories receiving less than \$10.10. The Department then took ratios from USASpending.gov and the Bureau of Labor Statistics Office of Employment and Unemployment Statistics ("OEUS") to estimate what percentage of applicable CPS workers

¹² <http://econ.lse.ac.uk/staff/bpetrong/ec423/lecture3.pdf>

¹³ <http://www.nber.org/papers/w2101.pdf>

¹⁴ http://www.bls.gov/jlt/jlt_labstatgraphs_March2014.pdf

receive less than \$10.10 and are on federal contracts - and then estimated what percentage of those individuals were covered by the EO.¹⁵

The Department projects that there are about 183,814 contractors who would be affected by the EO. It then gauges that the “average wage” of affected workers is \$8.79, but does not specify whether “average” refers to the mean wage or the median wage, which can be significantly different. Further analysis shows that contractors spend about 2,080 hours working per year under EO covered contracts. DOL concludes its evaluation by stating that 20% of contracts extant in 2015 will qualify as “new” for the purpose of this EO, and that by 2019 about all contracts will be “new” for the purpose of this EO. A calculation of 183,814 (workers) x \$1.31 (\$10.10-\$8.79) x 0.2 (percent contracts extant in 2015 qualified as “new”) produces an annual fiscal impact of \$100.2 million in 2015 and \$501 million in 2019 (183,814 x 1.31 x 2,080).¹⁶

The Department’s calculation for regulatory significance assumes inelastic demand for federal contractors. Although this is generally unreasonable in the private market, this might be a fair premise considering people cannot directly “fire” contractors. However, for the premise to be true, the higher costs of individual contracts would not affect agencies’ ability to procure services, which seems unlikely given budget constraints. The Department should evaluate retrospectively the validity of this assumption.

Disparate Impact and Unintended Consequences

Through the NPRM, the Department may actually contribute to the creation of a market failure: the presence of monopoly power. Beginning January 1, 2016, the Secretary will have the sole authority to adjust the federal contractor minimum wage (with some restrictions based on the consumer price index). However, the Secretary will not be able to decrease the wage, even if he/she deems it economically efficient.¹⁷ The Secretary also has the power to implement further regulations for enforcement processes and compliance.¹⁸ The Department should consider the potential negative ancillary consequences of the uniform wage mandate and develop plans to measure any effects.

This year, the Congressional Budget Office (“CBO”) reported that a minimum wage hike has the potential to decrease employment levels in the private sector by an estimated half million workers.¹⁹ The CBO has not conducted an economic impact analysis on the NPRM, but it is

¹⁵ 79 FR 34594

¹⁶ 79 FR 34594

¹⁷ 79 FR 34579

¹⁸ 79 FR 34586

¹⁹ Congressional Budget Office. *The Effects of a Minimum-Wage Increase on Employment and Family Income*. 18 Feb. 2014. <http://www.cbo.gov/publication/44995>

conceivable that this increase in the minimum wage for federally contracted workers has the potential to decrease worker hours or the number of workers assigned to a contract. Before the Department issues a final rule, it should account for these unintended consequences. It should develop a means of measuring the NPRM's effect on the actual workplace, such as the number of hours worked and the number of workers assigned to a contract, both in the aggregate and segmented to contracts of similar scope and size. When conducting review of the final rule, it would be prudent to first establish a baseline analysis of the current federally contracted labor market and estimate the regulatory impact of the NPRM. In this case, it will make retrospective review considerably easier and potentially more accurate.

David Neumark, an economist at the University of California Irvine, and associate of the National Bureau of Economic Research (NBER), and the Institute for the Study of Labor (IZA), focuses primarily on the economics of labor markets. He has conducted multiple studies that exhibit the unintended consequences of a minimum wage hike, and how these undermine the overall effectiveness of an increase in the minimum wage.²⁰ He concludes:

While low wages contribute to the dire economic straits of many poor and low-income families, the argument that a higher minimum wage is an effective way to improve their economic circumstances is not supported by the evidence.

First, a higher minimum wage discourages employers from using the very low-wage, low-skill workers that minimum wages are intended to help. A large body of evidence confirms that minimum wages reduce employment among low-wage, low-skill workers.

Second, minimum wages do a bad job of targeting poor and low-income families. Minimum wage laws mandate high wages for low-wage workers rather than higher earnings for low-income families. Low-income families need help to overcome poverty. Research for the US generally fails to find evidence that minimum wages help the poor, although some subgroups may be helped when minimum wages are combined with a subsidy program, like a targeted tax credit.

The minimum wage is ineffective at achieving the goal of helping poor and low-income families. More effective are policies that increase the incentives for members of poor and low-income families to work.²¹

²⁰ David Neumark and William Wascher, *Minimum Wages and Unemployment: A Review of Evidence from the New Minimum Wage Research*. Cambridge, MA: National Bureau of Economic Research, 2006

²¹ David Neumark, *Employment Effects of Minimum Wages: When minimum wages are introduced or raised, are there fewer jobs?* Irvine, California and IZA, Germany: IZA World of Labor, 2014

Measurement Criteria

In order to measure the success of the NPRM following implementation, it is necessary for the Department to define what constitutes a “success.” Any stated metrics of success should be linked to the problems identified: the Department should be able to measure whether federally contracted employees receive a higher standard of living on the whole (factoring in unemployment, reduced work hours due to the proposal, etc.) and that the taxpayers receive a net gain for the work being done via these contracts. The Department has determined that this proposed rule is a “significant regulatory action” under section 3(f) of Executive Order 12866 due to its estimated annual fiscal impacts of \$100.2 million in 2015 and \$501 million in 2019.²² The Department recognizes that this is a transfer payment, but asserts:

This is the estimated transfer cost from employers and taxpayers to workers in 2019. However, the Department expects offsetting of the cost increase due to workers’ increased productivity, reduced turnover, and other benefits as discussed in the Benefits section. In fact, as discussed below, the Department believes that the long-term cost savings to employers and the Federal Government justify the short-term costs that would be incurred.²³

In the final rule, the Department should develop some quantitative measures for evaluating these outcomes. Under its “Benefits” section, DOL cites studies that correlate higher wages with less absenteeism and turnover,²⁴ describes the efficient wage theory,²⁵ and other positive outcomes. Yet, DOL does not adequately enumerate how it will measure if the listed outcomes actually come to fruition.

Additionally, in the NPRM’s “Benefits” section, there is no explicit reference to differentiating high-skill vs. low-skill workers in terms of absenteeism and their associated wages or salaries. Instead of aggregating the data to find “that a one percent increase in wages is associated with a reduction in absenteeism of about one percent,” the Department should examine the impact on different skill levels, and present its plan to measure effects on different categories of workers.²⁶

In the same light, the Department should also retrospectively review how successful the rule was in achieving its goals of reducing worker absenteeism and turnover, improving morale and

²² 79 FR 34594

²³ 79 FR 34596

²⁴ 79 FR 34597

²⁵ 79 FR 34597

²⁶ 79 FR 34597

productivity, reducing supervisory costs, and increasing government service quality.²⁷ The NPRM states:

Much of the evidence supporting these predicted outcomes—encapsulated in the papers cited above—examines why firms voluntarily pay high wages. There may be differences between such firms and the contractors that would newly increase wages as a result of this proposed rule. Some may posit that a full accounting of these differences might change predictions of rule-induced impact.²⁸

Since the rule bases its predicted outcomes on wages negotiated voluntarily between private firms and workers, it will be very important for DOL to evaluate whether the causal linkages it assumes between raising the minimum wage and the stated outcomes are realized. In particular, the Department should focus on productivity and turnover since the data for those outcomes will likely be the easiest to collect. The Department should examine the causal relationship between these variables – and even potential exogenous factors influencing the outcomes. DOL should also measure potential negative impacts of the Executive Order such as increasing unemployment, adding barriers to entry for low skilled workers, and making it harder for would-be employees at previous minimum wage levels to find jobs in the present and gain experience for better positions later on in their careers.

Measure Linkages

As the Department commits to measuring the effects of the NPRM, it should also be aware of mediating factors that may have accomplished or undermined the stated metrics. These mediating factors may skew the results when the Department conducts retrospective review; it will have to determine if increasing the federal minimum wage had a positive or negative impact on employment figures or other factors affected employment and wages, such as the recovering economy, reduced barriers to entry in the labor market, or other Congressional spending or subsidies. Determining linkages between the rule and the measured outcomes is necessary to ensure that the policy itself resulted in the desired outcomes, rather than other factors beyond the Department's control.

Information Collection

This proposed rule does not pose any additional recordkeeping or reporting requirements on federal contractors, but nonetheless the Department is seeking comment to ascertain if this assumption is correct.²⁹

²⁷ 79 FR 34597

²⁸ 79 FR 34598

²⁹ 79 FR 34593

Consistent with the requirements of the Paperwork Reduction Act, the Department should identify or commit to collecting the information needed to measure the rule's success. Some information DOL should collect after implementation of the minimum wage increase includes, but is not limited to:

- Productivity of workers
- Morale of workers (if quantifiable)
- Turnover reduction
- Turnover costs
- Supervisory costs

DOL should also collect data on some potential unintended consequences of the proposed rule, including:

- Employment levels
- Number of contracts
- Number of workers assigned to contracts
- Hours of work performed on contracts by minimum wage/low-income laborers
- If the new mandatory wage is a barrier to entry for would-be workers

Timeframe

The text of the proposed rule does not include a timeframe for retrospective review, but does include estimates of impacts in two years following implementation. The Department predicts the proposed rule will have a \$100.2 million annual impact in 2015 and a \$501 million impact in 2019. The Department appropriately considers these “transfers” from employers and taxpayers to workers earning below the proposed \$10.10 minimum wage.³⁰ In the final rule, DOL should commit to measuring in the 2015 to 2019 time frame these impacts, as well as other predicted benefits such as “decreased turnover” or “higher productivity.”

Recommendations

DOL's proposal is implicitly based on presumed causal linkages between minimum wages, worker productivity, and more economic and efficient government programs. According to the Executive Order on which it is based,

Raising the pay of low-wage workers increases their morale and the productivity and quality of their work, lowers turnover and its accompanying costs, and

³⁰ 79 FR 34594

reduces supervisory costs. These savings and quality improvements will lead to improved economy and efficiency in Government procurement.³¹

In its final rule, as required by E.O. 13563, the Department should identify what measures will be appropriate to evaluate the rule's success at meeting its stated goals. To do this, the final rule should lay out a plan for retrospective review to validate these assumed linkages, and measure outcomes and intermediate impacts. DOL should also commit to examining possible unintended consequences (such as fewer jobs available for low-skilled workers at the higher wage) and any mediating factors that might influence outcomes.

³¹ 79 FR 9851