# The Economic Costs of Expanding the Family and Medical Leave Act to Small Business

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*The federal Family and Medical Leave Act (FMLA) became effective in April 1995, for firms with more than 50 employees. It has since been proposed in Congress to expand the coverage of FMLA to cover small businesses. NFIB's new Regulatory Impact Model (RIM) is used to study the effects of expanding the FMLA to firms with less than 50 employees. This paper focuses on estimation of three kinds of costs for small business owners that would be caused by an expansion of the FMLA: labor costs, management costs and various fees. The results of the analysis suggest that an expanded version of the FMLA would have serious, negative effects on the small business sector.*

When the Family and Medical Leave Act (FMLA) was first passed in 1993, and became effective in April 1995, small businesses with fewer than 50 employees were exempt. Since then, members of Congress have proposed expanding the 1993 FMLA to cover firms with 25-49 workers. Eventually all firms may be covered. Alternative state-based proposals to expand the FMLA—to include both paid leave and all employers--will impose major costs on small business owners, and this paper discusses how the NFIB's new Regulatory Impact Model (RIM) model is being used to measure these additional costs.

In past NFIB surveys of members, spanning a period of 5 years, virtually 90 percent of small business owners have consistently opposed expansion of coverage to <u>unpaid</u> family leave in the original FMLA. There is no reason to expect a smaller proportion would oppose <u>paid</u> family and medical leave in any form. In addition, 50-65 percent of small establishments already have FMLA programs in place for such conditions as illness of key employees, newborn care, and serious health conditions of children.[2]

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[1] I would like to thank Denny Dennis, Mark Wilson, Robert Crow and two anonymous referees for comments on earlier drafts; the remaining errors are mine.

[2] David Cantor, Jane Waldfogel,, Jeffrey Kerwin, Mareena McKinley Wright, Kerry Levin, John Rauch, Tracey Hagerty, Martha Stapleton Wright, "Balancing the Needs of Families and Employers: Family and Medical Leave

The derivation of the various costs discussed below relies on legal and economic studies that describe the effects of the 1993 FMLA on larger business. In the original formulation of the FMLA[3], workers could apply for 12 weeks of *unpaid* leave if:

a) They worked at least 1250 hours for a firm in the previous year (this is equivalent to about 24.5 hours per week);
b) They had a serious medical condition, as documented by a physician;
c) They experienced the birth or adoption of a child, needed to care for an elderly parent or a sick child or spouse, or for the employee himself or herself; or
d) They applied at least 48 hours in advance, if possible, before starting a period of unpaid leave.

**How has the act worked thus far?[4]**

There were two reports to Congress on the implementation of the FMLA, in 1996 and 2000.[5] The original FMLA applied to large firms with 50 or more employees at all covered sites, even if more than one location was involved. Most of the reported initial costs associated with the Act were fairly small. However, 41.9 percent of employees at covered establishments were initially unaware of the law.[6] In 1995, according to the first Congressional report, 85.1 percent of employers reported that the FMLA law was easy to comply with. However, by 2000, as knowledge of the law increased, the percentage of employers reporting that the FMLA was easy to comply with declined from 85.1 percent to 63.6 percent.[7]

Problems arose when employees chose to use family and medical leave in very small increments and improperly communicated such needs to their supervisors: termination was sometimes the result. However, because almost all larger companies have very carefully written personnel manuals and a team of attorneys, employers won many of these "wrongful termination" cases.[8]

In addition, by 2000, employers covered by the FMLA complained about additional record-keeping (38 percent), the coordination of state and federal leave policies (40 percent),

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Surveys, 2000 Update." Prepared for the Department of Labor by Westat Inc., Rockville, MD under Contract MS-23F-8144H, 2001, Chapter 5, Table 5.1. Note that establishments and firms are not the same. A firm may consist of one or more establishments with a common owner. Therefore the results cited above may not necessarily apply to small firms.

[3] The original FMLA Act is found in 29 CFR chapter 825, part 110.

[4] I wish to thank Mary Leon and Lara Chamberlain for help in this section of the paper.

[5] For the 1995 survey, see U. S. Department of Labor, Report of the Commission on Family and Medical Leave, Executive Summary and Chapter 6, "Assessing the Impact of Family and Medical Leave Policies on Employers>" See also www.dol.gov./esa/public/regs/compliance/whd/fmla/summary.htm. The 2000 report has been cited above and is on the internet at www.dol.gov/asp/fmla/main.html. The 2000 surveys are also on the internet at www.dol.gov/asp/fmla/database.html

[6] Jane Waldfogel, "Family and Medical Leave: Evidence from the 2000 Surveys." Monthly Labor Review, " September, 2001, pp. 17-23.

[7] Waldfogel, op, cit., pg. 19.

[8] Steven Hymowitz and Edward F. Harold, "Family and Medical Leave Act Developments." National Employment Law Institute Law Briefing, Key West, Florida, March 20-27, 2000.

coordinating the Act with other federal laws (35 percent), and coordination of the Act with the firms' other leave policies (35 percent).[9]

The studies also found that the median amount of unpaid leave taken by FMLA users remained at about 10 days between 1995 and 2000.[10] Some employees at the bottom of the wage scale wanted to take more time off, but could not afford to. The largest users of family leave were employees concerned with their own health and married women with children. In addition, the percentage taking leave to care for an ill spouse or ill parent significantly increased between 1995 and 2000. [11]

Of even greater potential importance to small business, should the coverage of FMLA be expanded, 17 percent of covered employers reported negative effects on productivity; and 19 percent reported negative effects on absences in 2000 as a result of the FMLA. About 10 percent reported declines in profitability.[12]

The original FMLA law required that an employer provide eight pieces of information in writing to an employee who requests FMLA leave. In the words of the Department of Labor regulations implementing the law, each covered employer must stipulate:

1. Whether the leave will be counted against the employee's FMLA leave entitlement;
2. Requirements for medical certification for a serious health condition and the consequences for failing to do so;
3. The employees right to substitute paid leave, and whether the employer will require the substitution of paid leave before beginning a period of unpaid leave;
4. Requirements for the employee to make health benefit premium payments; consequences for failing to make timely payments; and circumstances under which coverage might lapse;
5. Requirements to submit a fitness-for-duty certificate to be restored to employment;
6. Employee's status as a key employee; [13]
7. Employee's right to restoration when leave is completed;
8. Employee's potential liability, if the employee fails to return to work, for employer-paid health insurance premium payments while the employee is on unpaid FMLA leave.[14]

Even for a large firm, sorting/storing this much paperwork is a large burden. The paperwork often requires a more sophisticated bookkeeping system. The Department of Labor and the Government Accounting Office estimated the annual cost to employers at $825 million.[15] In a paper for the Mercatus Center at George Mason University, Joseph Johnson estimated the FMLA

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[9] David Cantor et al., Balancing the Needs of Families and Employers, op cit. Chapter 6, table 6.4 .
[10] Commission on Family Leave: Report to Congress, Executive Summary, page 6.; the 200 data is quoted in Waldfogel, op. cit., page 19.
[11] Ibid, pg 20.
[12] David Cantor, et al. "Balancing the Needs of Families and Employers," op cit. Chapter 6, Table 6.5.
[13] The designation as an employee of a business as being a "key" or critical employee is left up to the employer. It can be a subjective judgment on the part of the employer.
[14] Family and Medical Leave Act: Employer Advisor—Employer Notification Responsibilities: http://www.elaws.dol.gov/scripts/return.exe
[15] At an assumed clerical cost of $20/hr, this would equal 41.25 million burden hours.

burden at between $3.9 billion and $24 billion per year. [16] Even at the low end, this burden translates into a paperwork burden of perhaps 390 million hours in larger firms. These kinds of problems associated with the 1993 FMLA have led to calls and coalitions to fix it, before considering any expansion to smaller firms.[17]

**How many employers have been impacted by the FMLA thus far?**

According to Gerstel and McGonagle (1999), one-fifth of surveyed employees in 1995 perceived a need to take family leave, and about four fifths of that one-fifth (or about 16 percent) actually took it. Expanding the FMLA to firms with 1-49 employees by extension would include an additional 5.05 million employees. (The 5.05 million additional employees is derived from 16 percent times 31.59 million employees in firms with less than 50 employees equals 5.05 million employees, using 1998 Census data.) [18] If it were true that one employee in every five firms with 1-49 employees took FMLA based upon the above percentages, then 16 percent of 5.37 million small firms—or 859 thousand firms with less than 50 employees-- would be affected.

**How has the FMLA changed? The states enter.**

Beginning about 1998, and spurred on by Clinton administration proposals, various advocates of strengthening the FMLA made several additional proposals. These proposals came from both the outgoing administration, and state FMLA advocates.[19] Proposals from the state advocates took two basic forms:

a) Using the unemployment insurance (UI) system to *pay* workers while they were on leave (the so-called Baby UI proposals);
b) Extending the FMLA law to firms with 25-49 employees, and eventually to all small business employers (some states apply portions of it already to firms with 6 or more employees).

There is no prototype state FMLA bill, but our model assumes a form of paid FMLA leave of 12 weeks duration, applicable to small firms with fewer than 50 employees. We do not yet know which states will cover which conditions; some states may cover only pregnancy and adoption, while others will also include personal illness and care for sick parents and children. We assume, for modeling purposes, that all causes permitting a period of unpaid FMLA in the federal Act will be included in the proposed paid FMLA state acts.

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[16] Joseph J. Johnson, "A Review and Synthesis of the Cost of Workplace Regulations." Mercatus Center, George Mason University, Fairfax, Va., August 30, 2001, pp15-16.

[17] See www.workingforthefuture.org for a description of the proposed Technical Corrections Act to the original FMLA Act.

[18] Naomi Gerstel and Katherine McGonagle, "Job Leaves and the Limits of the Family and Medical Leave Act: The Effects of Gender, Race and Family." Work and Occupations 26(4), November, 1999, pp. 510-534. The 1995 telephone survey had 2,253 respondents in firms with more than 50 employees, with a weighted response rate of 73 percent.

[19] See "Unemployment Insurance Paid Leave Initiatives-2001: Updated 9/12/01. Source: www.ows.dolewta.gov.chart2001 asap; see also "State Round Up-State Family Leave Benefit Initiatives- Making Family Leave More Affordable, March, 2001. Found on www.nationalpartnersip.org/workand family/fmleave/flinsur.htm

As of July 2001, legislators in 27 states had introduced paid family leave bills. Most of these state bills have not yet passed. However, two states – Vermont and Oregon – already have comprehensive (unpaid) family and medical leave laws, which apply to firms of 10-25 employees.[20] Twelve states have narrower leave laws that apply to employers of fewer than 50 employees. Many of these refer to maternity leave only.[21] Eight additional states require leave for participation in children's educational activities. Vermont and Massachusetts require leave for the emergency needs of a child, spouse or elderly relative.[22] And twenty additional states have held hearings on family leave bills.[23] These bills—as indicated above—differ widely, providing either 12 weeks of paid or unpaid leave, often only for maternity reasons.

How will the state FMLA bills be financed? Some states propose increases in payroll (UI) taxes to pay for these programs, after allowing employees to use available sick leave. Still others suggest employer funded "temporary disability policies" which provide benefits (up to a maximum) during a period of leave. Some of the estimated costs of the temporary disability bills have ranged from $0.88 per covered employee per week in California to a payroll tax contribution of 2 cents per hour from employers and employees in Hawaii. [24] [25] Many other states have not yet provided direct cost estimates as of the end of the 2001 legislative session. [26]

To better understand the effects of these proposals on the small business sector, NFIB's new RIM was employed to calculate the costs of an expanded FMLA leave program on small business owners.

**Preparing to use NFIB's Regulatory Impact Model (RIM) to study an expansion of the FMLA**

The proposal being modeled is a 12-week period of paid family and medical leave. Some leave takers would be paid their salaries/wages, but most state proposals cap this at a level near the current level of unemployment compensation.[27]. It will include the same notification requirements of the federal FMLA described above, and include the requirement of employer paid health insurance (if the firm offers it) during the period of paid leave. As in the federal statue, it will also require small employers to designate which employees in their businesses are "key" or critical employees, and require "fitness for duty" letters before an employee can return to work.

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[20] Work and Family, "State Family Leave Laws That Are More Expansive than the Federal Family and Medical Leave Act." http://www.nationalpartnership.org/workaandfamily/fmleave/statelaw.hrtml , March 3, 1999.

[21] Ibid. These states are Kentucky, Hawaii, Montana, Connecticut, Iowa, California, Massachusetts, New Hampshire, Minnesota, Maine, Louisiana and Puerto Rico. The laws apply to firms with 3-25 employees, depending upon the state.

[22] Ibid. These states are California, the District of Columbia, Illinois, Louisiana, Massachusetts, Minnesota, Nevada and Vermont. These laws provide for 16-40 hours of unpaid leave, depending upon the state.

[23] I wish to thank Dave Stephenson for providing this information; it is also found on www.ows.doleta.gov/unemploy/chart.asp.

[24] See "Work and Family: State Round-Up: State Family Leave Benefit Initiatives: Making Family Leave More Affordable:, March, 2001. http://www.nationalpartnership.org/workandfamily/fmleave/flinsur.html ,

[25] See also www.ows.doleta.gov/unemploy/chart.asp.

[26] Ibid.

[27] For modeling purposes, we assume that employees are paid at the current level of unemployment in each particular state.

The requirements of the RIM and the evidence from previous studies of compliance with the FMLA of 1993 indicate that for analytic purposes, the economy is divided into four parts. The four parts consist of a 2X2 matrix using two classes of industry and two of firm size. Industries are combined as shown below based upon the observed "compliance rates" thus far with the FMLA. "Compliance rate" refers to the actual percentage of small employers that fully inform their employees of their rights under the federal FMLA law and proposed state expansions. They also follow all applicable provisions of the current FMLA regulations, and any expansions.

The first group of capital-intensive industries (below) has had "compliance rates" in the 90 percent range; the second group has had compliance rates in the 60 percent range.[28] These groups are:[29]

1. Firms in Manufacturing, Mining, and Finance, Insurance and Real Estate with more than 20 employees. Studies have shown that large firms in these sectors have had compliance rates of about 90 percent with the FMLA;

2. Firms in Agricultural Services, Forestry, Fishing, Construction, Trade and Services with more than 20 employees. The literature records that large firms in these industries have a compliance rate with the FMLA of about 60 percent;

3. Firms in Manufacturing, Mining, and Finance, Insurance and Real Estate with less than 20 employees. In these industries, coverage of the FMLA is considered new. Compliance is likely to grow over time to the 90 percent historical FMLA average, but initially is set at 75 percent since not all small employers will become aware of the new paid FMLA law at once. The 75 percent figure is arbitrary.

4. Firms in Agricultural Services, Forestry, Fishing, Construction, Trade and other Services with less than 20 employees. Again, initial compliance is assumed to be about 45 percent – based upon the 2000 FMLA surveys – gradually growing to an assumed 60 percent.

**FMLA regulatory compliance costs needed by RIM**

RIM demands that the user enter different kinds of regulatory compliance costs. These costs include 1) labor costs—such as overtime wages paid and other benefit costs such as health insurance costs, 2) management costs such as creating personnel manuals or revisions to existing personnel manuals to bring a firm into FMLA compliance, and 3) fees such as increases in unemployment insurance rates needed to pay for a "Baby UI" FMLA program and declines in labor productivity caused by an expansion of the Act. These costs are discussed below.

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[28] This is a difficult issue because 15 percent of covered establishments with more than 50 employees do not always offer FMLA coverage. In addition, according to the 2000 FMLA survey; about 50 percent of non- covered establishments already offer some FMLA coverage. Compliance rates then represent estimated weighted averages based upon data that we do know and assumed information about firms based on what we cannot yet observe.
[29] We use firms with more than 20 employees to represent large firms because of the requirements of the RIM; firms with less than 20 employees represent small firms.

*Increased Employer Labor Costs*

The Use of Temporary Workers

If FMLA leave is expanded to include small employers, about a quarter of the 859 thousand firms with less than 20 employees--or 215 thousand of them--will be impacted. [30] A recent NFIB Poll on Labor Force issues observed that between 12 and 20 percent of surveyed employers in 2001 used temporary workers to replace people in critical, hard-to-fill jobs during labor shortages.[31] Also, a previous 1991 NFIB Foundation survey suggests that 25-30 percent of small employers used temps to cover employee shortages during periods of unpaid leave.[32] Therefore, we assume that if FMLA leave is expanded to small firms, about a quarter or 54 thousand firms will use temps.[33] (We assume one temp per firm per day for modeling purposes).

The average cost of a clerical temp in D.C. is between $18-$22 per hour – perhaps about 25 percent higher than in the U.S. as a whole.[34] We assume an estimated cost of $20 per hour per temporary employee. Given an eight- hour day, this is a cost of $160/day.[35] Therefore, for a twelve- week period of FMLA leave, the cost would be $160/day times 60 work days in a 12 week FMLA period, or $9600 for each replaced employee. (Again, we assume one replaced employee per employer for the 25 percent of firms for which the law will apply.) This cost is in addition to the cost of unemployment insurance. (Remember that employees are being paid directly by the states, and the increased UI taxes are used to offset these additional costs.)

It is not known if the use of temps will increase proportionately if the FMLA law is expanded to include paid leave, but the most conservative assumption is that there will be no proportionate expansion of temps. Rather, employees and owners of small firms will work longer hours.[36]

Overtime Wages For Non-Temporary Workers

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[30] Gerstel and McGonagle, op cit.,

[31] NFIB National Small Business Poll: The Changing Search for Employees: I(1), (Washington, D.C., 2001) , p.12.

[32] W.. Stephen Barnett and Gerald L. Musgrave, "The Economic Impact of Mandated Family Leave on Small Businesses and Their Employees." (NFIB Foundation, Washington, D.C., 1991), pp.14

[33] This estimate is also based upon Naomi Gerstel and Katherine, "Job Leaves and the Limits of the Family and Medical Leave Act: The Effects of Gender, Race and Family." Work and Occupations 26 (4), Nov. 1999, pp. 510-534. Based upon a 1995 telephone survey, one fifth of the employed felt a need to take family leave, and 16 percent actually took it during the surveyed year. Applying the 1998 figure for the number of firms with fewer than 50 employs yields a result of 859 thousand firms.

[34] This is clearly a biased representation of what can be expected in the U.S. as a whole, given that the rate in DC is significantly above the national average. However, even using an hourly employer cost of $16 per hour for these workers, the difference in total costs going into the RIM model is between 4-6 percent. Therefore, the difference between the preferred $16 per hour and the assumed $20 per hour for temps in the D.C. area imparts an upward cost bias of 4-6 percent. The results reported below in tables 1-4 should therefore be deflated by about 5 percent to produce somewhat greater reality from the effects of the FMLA.

[35] Based upon 8 hours per day at $20/hour.

[36] NFIB Education Foundation, "The Changing Search for Employees," 2001, op. cit.

About 62 percent of small employers increase employee hours rather than use temps, during periods of labor shortages.[37] Wage costs (including overtime compensation and bonuses) therefore expand. These costs will apply to the three quarters of the small business owners who *do not* use temps – but who expand hours – to comply with periods of leave caused by the FMLA.

Workers in small firms also often work longer hours than workers in larger firms, especially in retail and service firms. Many recent news articles have also been concerned about the mandatory overtime imposed by many business owners in firms of all sizes. Therefore, assuming expanded paid overtime hours if a Baby UI paid leave program is instituted is probably reasonable.

At an estimated average payroll cost of $13/hr in small firms, [38] we assume an FMLA wage rate of $20/hour (which includes overtime). If overtime wages apply to all four industrial sectors listed above, the number of likely impacted firms is .75 x 215,000 = 161 thousand small employers that pay overtime.[39] The additional labor cost is then $20/hr ($160/day) times 60 days (12 weeks of FMLA) = $9,600 per employer for each FMLA employee on extended leave. [40] (This assumes that the overtime compensates hour-for-hour for the leave-taker, which may not be true). One plausible alternative assumption is that overtime workers will work harder and that some things will be deferred or not done at all, leading to less than hour-for-hour replacement). However, with no hour-to-hour replacement, it is possible for some sales to be lost, as indicated below.

For larger firms, for RIM purposes, we assume that these costs of temporary clerical workers also apply. While larger firms sometimes make greater use of temporary workers, this behavioral assumption requires further research, and increases in overtime hours among larger firms to compensate for longer hours is also probably reasonable.[41] To simplify the assumptions for the RIM, the percentage of firms using temporary workers and paying overtime to workers is assumed identical. However, we assume a higher overtime wage rate in larger firms.

In the 2 industrial groups listed above, consisting of larger firms with more than 20 employees, the average payroll cost per clerical employee was about $16/hour, with an assumed overtime rate of $24/hour. These data will be included in RIM runs discussed below.

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[37] Ibid.

[38] This is based upon 1998 SBA/Census data for all firms with fewer than 20 employees This is payroll per employee divided by 2080 hours, or a full year.

[39] Of course, in reality, not all firms will pay overtime. But some owners may also provide a bonus for the increased hours needed to cover for absentee workers,

[40] This amount is clearly an upper limit .If there is one period of paid leave per every four firms, this figure must be reduced by 75 percent in the actual modeling effort.

[41] In this exercise, it is not possible to distinguish between exempt employees (not eligible for overtime), and non-exempt employees (not eligible for overtime).

*Employer Health Benefit Cost Increases*

By federal law, business owners must maintain the health insurance of employees who choose to take FMLA. This is also likely to be true of state type Baby UI proposals as well, if they apply to small firms. These health insurance requirements add to employer costs.

First, for purposes of modeling this cost, it is necessary to calculate the cost of 12 weeks of health insurance coverage for different sized employers. Many workers will likely take less than 12 weeks paid leave and therefore cost employers less, but for a first approximation -- since we do not know the exact baby-UI proposals -- we assume that the full twelve weeks of leave will be taken. (Remember that the average number of days of *unpaid* leave was ten days, while we are assuming that the average number of days of *paid* leave is 60.[42] As indicated in footnote 41, this assumption is probably excessive, except in longer run health or adverse family situations. [43]

From the 2000 and 2001 health surveys of the Kaiser Family Foundation, we know that annual family health coverage in finance and manufacturing costs about $7,226; in small firms that offer coverage, the costs are slightly lower at about $7,067. For the remaining industries (dominated by retail trade and services), the comparable data for 2001 are about $6,545 in smaller firms and $ 6,790 in larger firms. [44]

For an employer forced to continue to pay health benefits during a 12-week period of extended leave, the cost is approximately 12/52 or 23 percent of the annual cost. In the examples provided above, this means about $1,625 per FMLA employee in the capital-intensive sectors like finance and manufacturing, and about $1,505 in smaller firms in trade and services. [45]

For modeling purposes, we will also assume that these additional health care costs apply to the two more capital-intensive, larger firm sectors above.

**Additional Management Costs Associated With Increases in the FMLA**

The first and most basic cost is the small business owner's time to understand the new FMLA law, obtain the necessary eight forms from the Labor Department (see above), and explain the law to supervisory or other employees. We assume these costs at $500/firm ($50/hr times 10

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[42]The reality is that because most folks take about ten days of unpaid leave currently, most will probably not take the full 60 days, even if they are paid to do it. In the 2000 FMLA report to Congress, most employees were too worried about their jobs and careers to consider more than a few weeks off, unless absolutely necessary because of individual health or family considerations.

[43] Because there was an income mix in the use of unpaid FMLA, (e.g. lower paid workers took off less time, higher paid workers took off more time), we don't know how this mix will change when *paid* leave is introduced).

[44] These numbers are derived by using weighted averages of both the industry and frm size data from the 2001 Health Survey of the Kaiser Family Foundation: http//www.kff.org. We use the data for family rather than individual coverage because married women are the most likely to take family leave, based upon the evaluation studies done so far.

[45] In the RIM, health insurance is supplied by the sector, "Finance, Insurance, and Real Estate." These data already include the increase of 16.5 percent in health care costs in small firm sin 2001, and 10.5 percent in larger firms (over 200 employees) in 2001. It is also likely that some small firms will drop health insurance coverage from these cost increases.

hours).[46] We apply these costs to the industrial sectors above and assume that they are a continuing cost.[47] If the small business owner were to hire a consultant for this purpose, this cost would be an additional management cost.

For larger firms, which presumably already understand and comply 90 percent of the time with the FMLA law in some industrial sectors, we assume these learning costs to be zero.

For small business owners newly exposed to an expanded federal or state FMLA, we assume that a business owner will need a consultant to write or re-write each small firm's benefit package, especially the sick leave and vacation policies. Issues such as, "Can employees use up all of their sick leave before a period of FMLA leave starts?" will have to be answered? What about advancing sick leave? [48] The major reason business owners will need a consultant to rewrite benefit packages is to avoid future lawsuits by employees over issues such as these, as well as the payment of health insurance during leave periods.[49]

Consultants are likely to charge a range of fees for writing/ updating personnel manuals (or writing one from scratch if none previously exists). While we assume that this has already been accomplished for larger firms, we assume that it has not been done for firms with less than 20 employees, the majority of which have less than 10 employees. Therefore, for the two industrial sectors that consist of small firms with less than 20 employees, we assume this cost to be $ 2000 per firm, based upon 5 days of a consultant's time at $400/ day. [50]

Consulting fees are also necessary to deal with potential complex privacy issues. For example, if an expanded FMLA period is needed due to an employees HIV/AIDS condition, who is entitled to know such information? We assume that these "material costs" add an additional $500/firm per small firm based upon the estimates provided in OSHA's Health and Safety Program Rule. [51]

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[46] Amounts similar to this are found in the Initial Regulatory Flexibility Analysis done by many federal agencies. For further details, see U.S. Small Business Administration, Office of Advocacy, "Annual Report of the Chief Counsel for Advocacy on Implementation of the Regulatory Flexibility Act, Fiscal Year 1999 (Washington, D.C., GPO, March, 2000). Also, the 1980 Paperwork Reduction Act (PRA) asks for the initial and recurring costs of information collection, but the 1995 form revisions to do not get into specific categories of labor cost burden, such as management time.

[47] Clearly these costs will vary somewhat by state, but we cannot account for them in this national model. We also assume that provisions of the law change from year to year, requiring employers to continually become aware of them.

[48] These costs are called "Material Costs" in the RIM, and are supplied by the sector called "Legal and Professional Services."

[49] The largest number of lawsuits against business owners arising out of the FMLA come from employees who sue their employers, often arising out of non-existent personnel policies. For further details, see Steven Hymowitz and Edward F. Harold, "Family and Medical Leave Act Developments." (National Employment Law Institute 20000 Law Briefing, Key West, Florida, March 20-27, 2000." See also W. Steven Barnett and Gerald L Musgrave, "The Economic Impact of Mandated Family Leave on Small Businesses and Their Employees." (The NFIB Foundation, Washington, D.C., 1991)

[50] A similar amount was used to examine a business firm for hazards—and entering such hazards into employee manuals—in the SBFREFA panel's analysis of OSHA's proposed Health and Safety Program rule. For further details, see Phillips and Dennis, op cit. Remember that we are also assuming only a 50 percent compliance rate when this rule initially goes into effect.

[51] Bruce D. Phillips and William J. Dennis, "Better Measures of Regulatory Costs as Support for Entrepreneurship." Revised August 2001. Prepared for the 2001 Babson Entrepreneurship Conference, Jonkoping, Sweden, June 2001.

These costs will only be applied to the small firm sector, since larger firms generally appear to have privacy rules in place already, based upon their SEC 10-K filings consumer literature.

Increased record keeping costs due to the expanded FMLA and some new computer programs or ledger books may be needed. We assume a nominal bookkeeping cost of $1000 per small firm per year (20 hours at $50/hr) to track and file any government-mandated paperwork on compliance with state and/or federal FMLA expansions. These costs are assumed to be virtually zero for larger firms because the needed information may often be found in other mandated regulatory compliance reports already prepared for federal government agencies such as EPA, OSHA, or Commerce.

**Additional Fees Associated With Expansions in the FMLA**

*Increases in Unemployment Insurance (UI) Taxes* – If the states are going to adopt an extended paid FMLA program, it will not be possible to continue to use the UI trust funds before they are exhausted. The non-profit organization, Strategic Services on Unemployment and Workers Compensation (UWC), argues that a Baby UI program will put all employers at a risk of a large increase in the FUTA tax rate. [52] [53]

Assume that if a "Baby UI" program is put in place, the percentage of workers taking paid leave will rise from the present 16 percent to 25 percent of the work force, a reasonably conservative assumption. There are about 20.3 million employed workers in firms with fewer than 20 workers in the labor force and approximately 19.4 million workers in firms with 20-99 employees. [54] Therefore, about 5.08 million workers in small firms (.25X 20.3) and 4.85 million workers in larger firms with 20-99 employees (.25 X 19.4) might be expected to apply for a period of paid FMLA.

How much would these workers receive? Assuming the national average unemployment compensation of $220 per week, this is equivalent to each FMLA recipient receiving $2,640 over a 12- week period. The amounts that will need to be replaced from the state UI trust funds are about $13.4 billion dollars from workers taking leave in small firms, and $12.8 billion from workers taking leave from larger firms. Since there are about 5.08 million small firms with fewer than 20 employees, dividing $13.4 billion by 5.08 million small firms equals $2,686 per small firm that will be returned to the UI trust funds. In the case of larger firms, dividing the $12.8 billion cost by 574,421 firms is equivalent to $22,631 per firm that will be returned. These costs are called "fees" in the RIM and are shown in Table 1.

*Rehiring (Recruiting) Costs to Replace Workers Who Never Return* – While these costs are a function of labor market tightness, they are also difficult to predict. Costs depend on whether the employee on extended FMLA leave who quits is a "key" employee. This is a difficult cost to model directly, and the literature offers little data to derive the probability that a worker on FMLA leave will never return, or will quit within a short time after returning. In the 1995 report

[52] Ibid.
[53] In the RIM, tax rate changes and similar government related mandates are called fees.
[54] http://www.sba.gov.advo/stats

of the FMLA Commission, 84 percent of leave takers returned to their same employers, 6 percent changed employers and 10 percent left the labor force.[55]

In the 1991 NFIB survey on mandated family leave, about 24 percent of employees who took unpaid leave in small firms quit when the period of leave expired.[56] Thus 76 percent of leave takers in small firms returned to their original employers.

Since many employers use recruiting bonuses for hard to find workers, a modest fee of $3000 per firm seems a reasonable cost. This would be equivalent to paying a personnel agency a month's salary in recruiting fee for a $36,000 a year employee. (Ten percent is often the industry standard for placing employees.) We assume for modeling purposes that both small and large firms will pay the same $3000 referral bonus for a new employee.[57]

*Decline in Worker Productivity From Increased Absences* – There is more likely to be a decline in labor productivity when a "key" employee is absent for an extended FMLA period. This is more likely to be true in small organizations, since there may be no other person capable of performing similar, multiple tasks. Productivity declines can take many forms: shoddy customer service in retail trade and services leading to sales declines; production mistakes in small manufacturing firms leading to increased returns from retailers; increased accidents by substitute drivers in transportation companies; lower sales in marketing companies; and fewer new patients/clients in professional services firms. These spot shortages slow everything down, and it takes longer to get the same tasks accomplished.

If productivity declines represent a loss of 10-15 percent of average sales, then we can use this percentage as a proxy for the unobservable productivity figure. According to SBA and Census data, average sales in a typical 20-employee firm in 1998 were $562,000.[58] A 10 percent decline in sales would be about $56,000 across the economy. Applied to a 12-week period of paid FMLA leave, that sales decline or "productivity tax" would be $12,880.

Some evidence for the productivity tax or sales loss comes from the 1991 NFIB Foundation survey of almost 1,000 small business owners. When owners with a family leave policy were asked if they sent "work to another firm to be done," as a result of recently granting family leave, 5 percent of small owners (under 50 employees) said "yes."[59] Therefore the productivity tax is an average 5 percent sales loss per firm applied to the 16 percent of workers in firms that have a worker on paid FMLA. This figure is therefore .16 x $12,880 or $2,061.[60] Clearly, this figure could double or triple if a single small firm had more than one worker or more than one key worker out on paid FMLA leave at the same time.

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[55] Commission on Family and Medical Leave, op cit., Executive Summary, pg 7.
[56] Barnett and Musgrave, op cit..
[57] The smaller firm is less likely to pay this fee unless the missing employee is crucial to the firm's operation.
[58] http://www.sba.gov/advo/stats, Click on data by firm size.
[59] W. Steven Barnett and Gerald L. Musgrave, "The Economic Impact Of Mandated Family Leave On Small Businesses and Their Employees." (NFIB Foundation Washington, D.C., 1991), table 7, pp.14.
[60] This figure would be slightly higher if 25 percent of the firm's work force were assumed to be absent due to a reason associated with the "baby-UI" FMLA law.

We assume that larger firms do not suffer this sales loss.[61]

*Non-Quantifiable Costs* – We cannot model the probability that very small firms will hire fewer young females and fewer less skilled workers if a mandated paid FMLA program goes into effect. But past surveys have indicated that as many as 30-40 percent of very small firms might do so.[62] In addition, the provision of health benefits to the vast majority of the small firm labor force would likely decline due to cost increases caused by the FMLA.[63]

### Running the RIM and Results

### Table 1 – FMLA Expansion Plan – Cost Inputs to the RIM

| COST / FIRM SIZE | I (Mining, Mfg, Finance) > 20 employees/firm | II (Ag Svcs, Trade, Const, Svcs) > 20 employees/firm | III (Mining, Fin Mfg) < 20 employees/firm | IV (Ag Svcs, Trade, Const, Svcs) < 20 employees/firm |
|---|---|---|---|---|
| LABOR COSTS | | | | |
| Overtime Wages: | 11,520 | 11,520 | 9,600 | 9,600 |
| Payments for Temps: | 9,600 | 9,600 | 9,600 | 9,600 |
| CONTINUATION COSTS: Health Insurance | 1,625 | 1,505 | 1,625 | 1,505 |
| MANAGEMENT COSTS | | | | |
| FMLA Law: | | | | |
| Cost of understanding | 0 | 0 | 500 | 500 |
| Employee Manual: Design/Revise/Update | 0 | 0 | 2,000 | 2,000 |
| Privacy Issues: | 0 | 0 | 500 | 500 |
| Record keeping Costs: | 0 | 0 | 1,000 | 1,000 |
| OTHER COSTS/FEES | | | | |
| UI Increases: | 22,631 | 22,631 | 2,686 | 2,686 |
| Retention/Rehiring Costs: | 3,000 | 3,000 | 3,000 | 3,000 |
| Unrealized Sales: | 0 | 0 | 2,061 | 2,061 |
| TOTAL COSTS PER FIRM (Assumes one FMLA leave per every 4 firms) | $48,376 | $48,256 | $32,572 | $32,452 |

As shown in Table 1, costs are divided into labor costs, management costs, and fees. Costs are displayed for the two firm sizes and the two industrial sectors discussed above. Notice that the single largest cost in Table 1 is the "UI Increase" of $23,000 in the large firm sector. Labor costs are the largest cost in the small firm sector. In addition, management costs were only assumed for small firms. While these may not quite be zero for all larger companies, most large firms

[61] Implicitly this assumes that larger firms are not as likely to suffer sales losses from employee absences due to the more capital intensive nature of most large firm operations (e.g. automated ordering operations, etc).
[62] NFIB 1991 Mandated Leave Survey, op cit.
[63] Census CPS data indicates that the number of uninsured in small firms has been rising the last few years without any mandated FMLA programs. Most of the studies have given annual double digit cost increases as the reason.

have lawyers that handle many federal regulations at one time, and accompanying litigation that flows from compliance problems with them.

The first two runs of the RIM were done for firms with less than 20 employees per firm, and for firms with less than 100 employees per firm. Virtually all of the costs that are imposed on the less-than-100 group are imposed on small business owners with fewer than 20 employees: the difference in costs for the two groups was negligible.

The employment results for the two firm sizes from imposing 12 weeks of paid leave on the economy are as seen below in Table 2:

**Table 2 – Employment Losses from an Expanded "Baby-UI" FMLA Program: 2003-2004**

Data in thousands

| Region | 2003 | | 2004 | |
|---|---|---|---|---|
| | Under 20 | Under 100 | Under 20 | Under 100 |
| U.S. Total | -30.8 | -31.7 | -33.1 | 34.1 |
| Northeast | -4.1 | -4.2 | -4.8 | -4.9 |
| Mid Atlantic | -2.4 | -2.5 | -3 | -3.1 |
| South | -7.8 | -8 | -7.1 | -7.3 |
| Great Lakes | -11.3 | -11.6 | -10 | -10.3 |
| Plains | -6.6 | -6.8 | -7.8 | -8.1 |
| Mountain | 3.6 | 3.7 | 1 | 1 |
| Pacific | -2.2 | -2.3 | -1.4 | -1.4 |

Note: Data may not add to totals due to rounding.

Regions defined as follows:
Northeast: CT, MA, ME, NH, NJ, NY, RI, VT
Mid Atlantic: DC, DE, MD, PA, VA, WV
South: AL, FL, GA, MS, NC, SC, TN
Great Lakes: IL, IN, KY, MI, OH, WI
Plains: AR, IA, KS, LA, MN, MO, ND, NE, OK, SD, TX
Mountain: AZ, CO, ID, MT, NM, NV, UT, WY
Pacific: AK, CA, HI, OR, WA

Imposing paid FMLA on very small business owners will cost the U.S. economy about 65,000 jobs during the next several years (Table 2). Indeed, the total would have been far larger, except that about half of very small business owners already offer some kind of paid FMLA program, according to the 2000 Report of the Family Leave Commission. Those business owners who cannot afford such a program, however, simply do not have the funds for re-writing personnel manuals; covering for absentee workers, giving up business, and paying higher payroll (UI) taxes. [64] Notice in Table 2 that there are virtually no differences in jobs lost between firms with

[64] Notice that these are non-salary costs. Wage and salary income to employees out on FMLA will come from the Unemployment Insurance (UI) system.

under 20 employees and firms with under 100 employees: the smallest firms will bear virtually all of the costs of a Baby UI program. Table 2 also indicates that the jobs lost will not be uniform: states especially in the Great Lakes region and in the South and Plains areas will suffer greater job losses than other regions.

Why might this be true? The Great Lakes region contains a disproportionate number of manufacturing firms, and it is possible that the jobs lost in other manufacturing-dependent sectors—like retail trade, construction and services—will have larger secondary impacts. Clearly more research is required to better understand these results. But the coastal regions—the Northeast and Pacific areas—appear to suffer much less from a "Baby-UI" program. It is possible that some of the small firms in these areas are already disproportionately in compliance because of the competition with larger companies that are more likely to be located in the Pacific and Northeast.

What do these job losses mean in terms of income lost in the economy? Table 3 below provides an answer:

**Table 3 – Losses in Real Disposable Personal Income from Imposition of a "BABY-UI" Program on Small Business Owners: 2003-2005**

(Firms with Fewer than 20 Employees)
Billions of 1992 Dollars

| | 2003 | 2004 | 2005 |
|---|---|---|---|
| U.S. Total | -4.4 | -4.6 | -2.6 |
| Northeast | -0.6 | -0.7 | -0.4 |
| Mid Atlantic | -0.5 | -0.5 | -0.3 |
| South | -0.8 | -0.8 | -0.5 |
| Great Lakes | -0.8 | -0.8 | -0.4 |
| Plains | -0.9 | -1 | -0.6 |
| Mountain | -0.3 | -0.4 | -0.3 |
| Pacific | -0.4 | -0.4 | -0.1 |

Notes: Details may not add totals due to rounding. The definition of the states in each region is found in the footnote to Table 2.

Essentially, Table 3 tells us that the economy will lose between 3 and 5 billion dollars a year as a result of imposing the FMLA. And while the jobs lost due to some regulations eventually return to the economy, much of the income and profit lost in small firms never return. Once again, the South, Plains and Great Lakes regions show the largest income losses.

### Job losses and gains by industry

When any new regulation is imposed on the economy, there are always some industry winners and losers. In the case of the FMLA, we observed above and in Table 1 that small business owners would be using temporary workers part of the time to make up for those on leave. Therefore, the business service sector—and the temporary help industry—would gain from this extension of FMLA. Similarly, because small business owners are required to maintain the health insurance of workers out on a period of FMLA, more money may be spent in the health insurance sector, if a small business provides health benefits in the first place.

Other likely winners under the ("Baby UI") FMLA are those legal firms and consulting firms that will be hired by small business owners to write personnel manuals to detail a very small firm's vacation, sick, overtime, and other benefit provisions. Examples of some industries that will lose and create jobs if an expanded FMLA law is passed are shown in Table 4 below:

**Table 4: Job Changes by Industry and Major Region From a "Baby-UI" Expanded FMLA Program in Small Firms With Less Than 20 Employees: 2003**

| Region: | Total U.S. | Northeast | Mid-Atlantic | South | Gt. Lakes | Plains | Mountain | Pacific |
|---|---|---|---|---|---|---|---|---|
| Sector: | | | | | | | | |
| Mfg of Equip. | -1387 | -176 | -112 | -192 | -411 | -286 | -71 | -146 |
| Construction | -12,556 | -1534 | -1362 | -2379 | -2420 | -2647 | -1110 | -1212 |
| Restaurants | -4985 | -619 | -457 | -985 | -966 | -992 | -456 | -578 |
| Misc. Retail | -15,841 | -2221 | -1602 | -3209 | -3072 | -3172 | -1234 | -1685 |
| Wholesale Trade | -4008 | -654 | -332 | -768 | -769 | -779 | -284 | -492 |
| Pers., Repair Svcs | -3,117 | -352 | -294 | -574 | -530 | -716 | -355 | -319 |
| Legal, Engineering Services | -3,181 | -447 | -325 | -608 | -692 | -642 | -153 | -308 |
| Social Services | -5596 | -786 | -679 | -895 | -966 | -1287 | -673 | -406 |
| | | | | | | | | |
| Insurance Carriers | 4801 | 867 | 548 | 567 | 619 | 1044 | 730 | 503 |
| Business Services | 44981 | 5824 | 4849 | 6972 | 4702 | 9125 | 9987 | 5302 |

Note: Regional detail may not add to U.S. totals due to rounding procedures in the RIM.
The states included in each region are found in footnote.

Notice that wholesale trade and retail trade (especially restaurants) will shed jobs if a paid FMLA program is imposed on the smallest business owners. Firms in these sectors will lose about 25,000 jobs during the first year in which the paid FMLA is implemented. Table 4 also indicates that the job losses will have different effects in different regions. While it is not clear why the construction industry will have such large job losses, it is possible that this sector is especially sensitive to higher costs, or Federal Reserve intervention.[65]

The business service sector emerges as the clear winner from a "Baby-UI " FMLA program, according to the RIM. Why? The largest reason is its' provision of temporaries to firms needing replacement workers on a short-term basis, especially in the Plains and Mountain regions. Without larger metro areas, the average firm is generally smaller in those areas, and even temporary workers may be harder to find. A Baby UI program may impact a larger percentage of

[65] More research is required here regarding the reasons why these workers are more likely to take FMLA. For example, are construction workers more likely to need time away from work to recover from injuries? While highly doubtful, the construction workers are disproportionately young.

firms in those areas. There could also be a mismatch between the age and experience of workers taking FMLA and those of available temporary replacements.[66]

Table 4 therefore shows how a regulatory scheme creates both winners and losers in the industrial base, despite an overall job loss caused by the regulation. Some sectors that produce or sell what is needed, personnel consultants in these cases, have a windfall, while almost every other sector—particularly those dependent upon discretionary spending—suffer a loss.

**Summary and Conclusions**

Imposing paid Family and Medical Leave on small business owners is likely to be costly, both to individual businesses and to the economy as a whole. On average, paid FMLA will cost $30K-$50K per firm in reduced sales, mandatory overtime payments, and diversion of management attention.

When the cost elements in Table 1 above were run through the RIM, it was found that at least 60 thousand jobs would be lost in small firms with fewer than 20 employees during the first three years after the rule takes effect. By then, over $8 billion dollars in disposable personal income will be lost to the consumption sector of the economy, spent instead on regulatory compliance costs and consultants. Almost $4 billion will be diverted in the first effective year of the expanded FMLA regulation.

The RIM showed that many jobs would be likely to be lost in small business, almost 40,000 in four sectors alone: restaurants, construction, other retail enterprises, and general services (personal and repair services). About the only sector to gain significantly from the expanded FMLA will be the business service consultants who would be hired to write all of the needed personnel manuals so that small business owners do not get sued from misinterpretations of their sick leave and disability policies.

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