

EVANSVILLE IN 1980 Estimate of Proposed Advance Notice Requirement



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Human Resources Division

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Honorable Edward M. Kennedy
Chairman, Committee on Labor and
Human Resources
United States Senate

Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Labor
Committee on Labor and
Human Resources
United States Senate

This letter responds to your February 9, 1988, request for our assessment of the study methodology and conclusions contained in the Robert R. Nathan Associates, Inc., report, The Private and Public Costs of Proposed Mandatory Advance Notification Legislation. In particular, you asked us to comment on:

1. The methodology used to estimate that an advance notice requirement would have resulted in 460,000 fewer jobs in the United States at the end of 1986.
2. The validity of the assumption that establishments covered by the advance notice requirement would incur an average administrative cost of \$15,000 per year.
3. The cost associated with employees quitting after receiving notice but before the closing, which is referred to as a "talent drain."
4. The estimated cost of legal penalties associated with noncompliance, considering exclusions in the legislation for establishments where less than a third of the work force is affected and establishments closing due to unforeseen business circumstances.

The jobs impact and administrative and penalty costs are among the factors that should be considered in debating the issue of advance notice. However, in our opinion, the methodology and analysis used by Nathan Associates to construct cost and employment estimates are inadequate to support the study's conclusions. It should be noted that given the current state of knowledge regarding the advance notice phenomenon, any estimate of these impacts would be extremely difficult, if not impossible, to develop.

Effect on Job Creation

The Nathan study estimated that between 1982 and 1986, about 460,000 fewer jobs would have been created in the United States if an advance notice requirement had been in effect. This estimate is based on a comparison of the rates of employment growth from 1982 through 1986 between a group of countries with advance notice requirements and a group without such requirements. The Nathan study then assumed that 10 percent of the difference in these employment growth rates was attributable to the effect of advance notice laws.

The method the Nathan study used in estimating the jobs impact of advance notice is straightforward, but ignores factors far more important than the presence or absence of an advance notice requirement. Therefore, the estimated employment impact cited in the Nathan study is not supported by the information and analysis presented.

The Nathan report acknowledges that no causality between advance notice laws and employment growth rates has been demonstrated, as indicated by the caveat that accompanies the presentation of this analysis in the report, which states “. . . these labor market performance differences cannot be attributed to either the existence or non-existence of advance notice laws” However, the authors nonetheless imply causality when they estimate a jobs impact resulting from notice requirements. Relevant factors omitted from the analysis include the vast differences in fiscal, monetary, and tax policy among the countries, and differences in population growth rates. Yet they conclude without support that 10 percent of the differential growth rate can be attributed to advance notice laws.

Even if the underlying basis for the analysis were valid, other aspects of the methodology raise questions regarding its validity, including the selection of countries used in the comparison and the time period covered by the analysis. The reasons for the selection of countries is unclear. Sixteen countries from Western Europe, Canada, and three newly industrialized countries (Brazil, Mexico, and Singapore) were selected to represent economies with advance notice laws. Their employment growth is compared with four economies without such laws—Hong Kong, Korea, Taiwan, and the United States. Japan, which requires advance notice and has a very strong economy, was excluded without explanation, as were other western economies without advance notice laws, such as Australia.

Lastly, the time period (1982-86) covered by the analysis was limited. Given the ready availability of longer time-series data on employment

and the fact that the period selected was one characterized by rapid growth in the United States following a recession, it would have been desirable to extend the period of analysis to include at least a full business cycle, rather than only the expansion phase.

Employer Costs

The Nathan study estimated that employers would incur yearly costs of \$1.8 billion as the result of the enactment of advance notice legislation from three sources: (1) the added administrative cost required of businesses to anticipate future market conditions and reach decisions regarding closings or layoffs well in advance of the event; (2) the cost associated with lost profits because workers provided advance notice would quit their jobs before their layoff date, causing a talent drain; and (3) penalties that would be paid by establishments failing to comply with the legislation's requirements. Much of this analysis draws on our plant closing and advance notice study, which estimated the number of establishments that closed or had a permanent layoff during 1983 and 1984, and the extent of advance notice provided.¹

Administrative Cost

The Nathan study estimated that the incremental administrative cost of developing and implementing management information systems capable of generating reliable data on which to base notification decisions and the cost of providing written notification to the affected parties would be about \$950 million a year. The Nathan study assumed that those establishments that provided 15 or more days of advance notice already had personnel involved in long-range planning sufficient to provide advance notice, if necessary. Using the advance notice data from our plant closing report, they estimated that about 39 percent of establishments had such planning ability. It was then assumed that the remaining 61 percent of establishments with 100 or more workers would incur the administrative cost of determining whether a closure or layoff was likely to occur. This cost was estimated as about \$15,000 for each establishment based on the assumption that one white collar worker would spend half time on this activity.

The Nathan assumption implies that 61 percent of large establishments do rather limited corporate planning. It can be argued that to be competitive, firms must look to the future to assess their needs for materials and labor relative to anticipated product demand and that many more

¹Plant Closings: Limited Advance Notice and Assistance Provided Dislocated Workers (GAO/HRD-87-105, July 17, 1987).

establishments than assumed in the Nathan study already plan well into the future.

In fact, firms make investment decisions that often require planning horizons measured in years and not months, for example, investment in plant and equipment. In addition, over 80 percent of all establishments with 100 or more workers are not independent firms but rather part of larger multi-establishment firms. In such firms, key decisions, such as closing a plant or having a significant layoff, would probably be made at the corporate level, where planning capacity well beyond that implicit in the Nathan cost estimate is likely already in existence. Therefore, to the extent that firms already have this planning capacity, the administrative cost estimate presented in the Nathan report is very likely overstated.

Talent Drain

The Nathan estimate that establishments announcing their plans to close in advance would suffer a loss of talent because experienced workers would quit before the facility closed may overstate the cost by ignoring offsetting gains and overstating the extent that workers quit their jobs before closing. A Conference Board study indicates that production workers generally do not leave before closure. Also, many employees would forfeit their right to severance pay if they quit before closure. Thus, it is possible that the talent drain effect is somewhat less than the Nathan report's \$6 million annual cost estimate.

Penalty Cost

The Nathan report estimates a penalty cost to employers who fail to comply with the legislation of about \$850 million annually. This cost is based on the assumption that establishments that GAO found to have given less than 15 days' notice would be subject to penalties. The penalty would apply to those establishments that provided less than 15 days' notice, 4,830 of the 7,410 establishments that were estimated to have closed or had a permanent layoff during 1983 and 1984, according to our plant closing survey. Two factors raise concerns regarding the Nathan estimate of penalty costs.

- First, the legislation excludes from the 60-day advance notice requirement establishments having a layoff that affects less than 33 percent of the work force. This would have excluded about 1,600, or about one-third, of the establishments that the Nathan study indicated would be subject to penalty. The estimated yearly penalty cost would, therefore, be reduced by about one-third, or \$278 million.

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- Second, the Nathan estimate made no allowance for establishments that were unable to provide sufficient notice due to unforeseen business circumstances, or other reasons specifically cited in the bill as sufficient reason to allow a waiver of the notice requirement. These establishments would, therefore, not be subject to penalty. This would further reduce the estimated cost.

In addition, it appears that the Nathan estimate includes significant double counting. Nathan assumed that 39 percent of establishments already had planning capacity to foresee a closure or layoff, so these establishments would incur neither additional administrative cost nor penalty. The remaining 61 percent of establishments were assumed to incur the administrative cost of planning and, therefore, would presumably be able to foresee closures and layoffs and provide sufficient advance notice. However, Nathan then assumed that these establishments would provide at most 14 days' notice. So that even though they were expending money for a planner, these firms would still provide insufficient notice and thus be required to pay penalties. However, if these establishments had planning capacity, yet were unable to provide the required 60 days' notice due to unforeseen business circumstances, they would not be subject to penalties. Thus, the Nathan methodology double counts the costs to 61 percent of all firms and necessarily overstates the annual cost by either \$950 million in administrative costs or \$850 million in penalty costs.

Unless you publicly announce its contents earlier, we plan no further distribution of this document until 30 days after its issue date. At that time, we will send copies to the appropriate Senate and House committees and subcommittees and other interested parties.



William J. Gainer
Associate Director

Related GAO Products

Parental Leave: Estimated Costs of H.R. 925, The Family and Medical Leave Act of 1987 (GAO/HRD-88-34, Nov. 10, 1987)

GAO's Estimate of the Costs of the "Parental and Medical Leave Act of 1987" (S. 249) (GAO/T-HRD-88-5, Oct. 29, 1987)

Plant Closings: Limited Advance Notice and Assistance Provided Dislocated Workers

(GAO/HRD-87-105, July 17, 1987)

S. 249, The "Parental and Medical Leave Act of 1987" (GAO/T-HRD-87-10, Apr. 23, 1987)

Dislocated Workers: Exemplary Local Projects Under the Job Training Partnership Act (GAO/HRD-87-70BR, Apr. 8, 1987)

Dislocated Workers: Local Programs and Outcomes Under the Job Training Partnership Act (GAO/HRD-87-41, Mar. 5, 1987)

Dislocated Workers: Extent of Business Closures, Layoffs, and the Public and Private Response (GAO/HRD-86-116BR, July 1, 1986)

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