THE HAMILTON PROJECT

STRATEGY PAPER

SEPTEMBER 2006

A Growth-Enhancing Approach to Economic Security

Jason E. Bordoff, Michael Deich, and Peter R. Orszag

The Brookings Institution

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by making economic growth broad-based, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments. Our strategy—strikingly different from the theories driving current economic policy—calls for fiscal discipline and for increased public investment in key growth-enhancing areas. The Project will put forward innovative policy ideas from leading economic thinkers throughout the United States—ideas based on experience and evidence, not ideology and doctrine—to introduce new, sometimes controversial, policy options into the national debate with the goal of improving our country's economic policy.

The Project is named after Alexander Hamilton, the nation's first treasury secretary, who laid the foundation for the modern American economy. Consistent with the guiding principles of the Project, Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces.

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Introduction

Overall macroeconomic growth is not translating into significantly improved economic well-being for most families. In addition to the well-documented stagnation in median wages during the past three decades, American families now face substantial new economic risks: The chance of family income dropping considerably from one year to the next has risen significantly. Workers are individually bearing more of the risk associated with health insurance and pensions. At the same time, the safety nets for those who are hit by economic shocks have frayed.

Government policies to help workers and families cope with these new risks must strike a delicate balance. On the one hand, shifting excessive economic risk to individuals can harm both economic growth and family well-being. On the other hand, poorly designed programs to protect against risks can distort economic incentives and impair overall economic performance. To date, most economic policy discussion has focused on this second potential problem. This briefing paper puts forward an alternative strategy for navigating between both potential problems, recognizing that well-designed policies can provide a basic level of economic security that is beneficial not only for families, but also for national economic growth.

In recent decades, many economic risks have been shifted onto individuals and away from employers and society as a whole.

The Problem of Growing Economic Insecurity

The growing economic insecurity faced by American families can be seen in the rising volatility of family income, in a shift of certain economic risks (largely involving pensions and health care) from employers to individuals, and in a fraying of the social safety net that was designed to help those who are hit by economic shocks.

Perhaps the most telling sign of increased economic risk is the growing instability of family income. While macroeconomic fluctuations in Gross Domestic Product (GDP) and unemployment have declined in recent decades, the volatility of family income has grown markedly.

Using data from the Panel Study of Income Dynamics (PSID), which has followed a nationally representative sample of about 5,000 families for nearly 40 years, researchers for the *Los Angeles Times* found that middle-class families in the 1970s faced annual income swings of about 15 percent a year; during the 1980s and 1990s, the volatility of families' income rose to between 25 and 30 percent a year (see Figure 1).[1]

Using the PSID and other data, Jacob S. Hacker of Yale University finds that about half of all families experience a drop in real income during any given two-year period; the median income drop for such families has risen significantly, however, from approximately 25 percent of income in the early 1970s to around 40 percent by the late 1990s and early 2000s.[2] According to Hacker's research, the probability of an average family experiencing a drop in family income of 50 percent or more increased from just over 7 percent at the beginning of the 1970s to nearly 17 percent by 2002.[3]

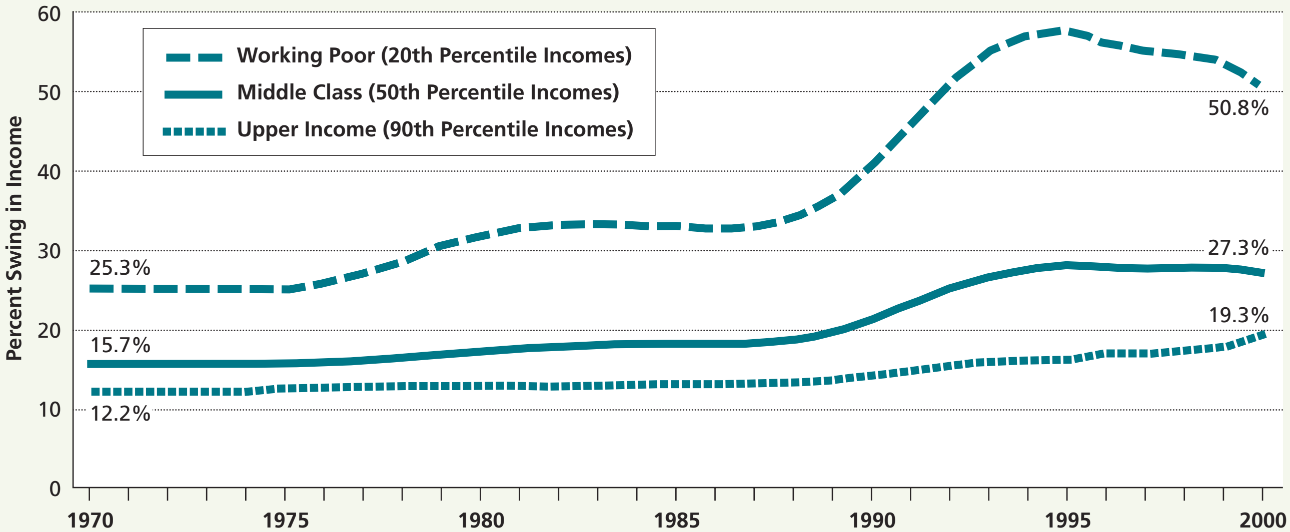
This increased income volatility results partly from a changing labor market. The American labor market has long been characterized by great flexibility: For example, at any time, about 20 percent of workers have been with their current employer for less than one year. This flexibility has been an important contributor to economic growth, allowing the rapid reallocation of workers in response to shifts in labor demand and other factors. In addition, because the direct costs of laying off workers have been relatively small, employers have been more comfortable hiring additional employees, even in the face of uncertain future demand.[4]

In recent years, however, this flexibility has imposed greater costs on American workers. Unemployment lasts longer than it used to. In the 1960s, the average spell of unemployment lasted about 12 weeks. Now it persists for 16 weeks.[5] And when displaced workers do find full-time work, they often end up earning lower wages. In 2003–05, roughly half of all long-ten-

1. Peter Gosselin, "The Poor Have More Things Today—Including Wild Income Swings," *Los Angeles Times*, December 12, 2004, http://www.latimes.com/business/la-fi-poor12dec12,1,5929236.story. See http://www.latimes.com/newdeal for a description of the research conducted by the *Los Angeles Times* in consultation with Robert Moffitt of Johns Hopkins University and others.
2. Jacob S. Hacker, "Universal Insurance: Enhancing Economic Security to Promote Opportunity" (Discussion Paper 2006–07, The Hamilton Project, Washington, DC, September 2006). See also Jacob S. Hacker, *The Great Risk Shift* (New York: Oxford University Press, 2006).
3. Hacker, "Universal Insurance."
4. Henry S. Farber, "What Do We Know about Job Loss in the United States?" *Economic Perspectives* (Federal Reserve Bank of Chicago, 2005) 2nd qtr: 13–28. http://www.chicagofed.org/publications/economicperspectives/ep_2qtr2005_part2_farber.pdf; Henry S. Farber, "Mobility and Stability: The Dynamics of Job Change in Labor Markets," in *The Handbook of Labor Economics*, Vol. 3B, ed. O. Ashenfelter and D. Card (Amsterdam: North Holland Publishing Company, 1999), 2439–2484, Table 3.
5. Lori G. Kletzer and Howard Rosen, "Reforming Unemployment Insurance for the Twenty-First Century Workforce" (Discussion Paper 2006–06, The Hamilton Project, Washington, DC, September 2006), 3.

FIGURE 1

Family Income Volatility, 1970–2000



Source: Peter Gosselin, "The Poor Have More Things Today—Including Wild Income Swings," *Los Angeles Times,* December 12, 2004, http://www.latimes.com/business/la-fi-poor12dec12,1,5929236.story

ured workers who were displaced from and then reemployed in full-time jobs experienced a drop in earnings, and nearly a third saw a drop of 20 percent or more.[6] On average, from 2001–03, reemployed workers earned around 17 percent less than they would have had they not been displaced.[7]

In addition to incomes that are more volatile, American workers face greater insecurity because many economic risks have been shifted onto individuals and away from employers and society as a whole. The shift to individualism and away from pooling risk across workers has been called you're-on-your-own economics.[8] You're-on-your-own economics celebrates the benefits of unfettered markets, and calls for policies that rely almost exclusively on the putative benefits of individual incentives such as reduced marginal tax rates. It pays little attention to market imperfections and limitations, such as those that result from costly and limited information, or to the reality of individual decision making, which can differ significantly from the perfectly rational behavior assumed in classical economics. It also ignores the absence of markets for various types of insurance, the fact that markets may not provide merit goods (such as health care) to the degree that society demands, and sometimes even the fact that government must set the rules under which markets operate. Instead of tempering a deep respect for market forces with a knowledge of their limitations, you're-on-your-own economics assumes that unfettered markets always produce the best of all possible outcomes. Under this view, improving economic performance is simply a matter of "getting government out of the way."

The embrace of this approach has resulted in policies that have increased individual risk in meeting such challenges as job loss, health care, and retirement security. As one example, unemployment insurance is doing less to cushion the blow of job loss than it used to. The U.S. Government Accountability Office found that, in part due to tighter state eligibility requirements, the fraction of unemployed workers who received unemployment insurance benefits fell each decade from an average of about 50 percent in the 1950s to an average of about 35 percent

6. U.S. Bureau of Labor Statistics, *Displaced Workers Summary*, August 17, 2006, http://www.bls.gov/news.release/disp.nr0.htm.
7. The magnitude of the expected drop in earnings following reemployment varies with the business cycle; the expected drop in earnings following the 2001 recession was larger than at any time in the prior two decades (Farber, "What Do We Know About Job Loss?"). The just-released *Displaced Workers Survey* for 2003 to 2005 shows that the percentage of reemployed displaced workers who experienced earnings losses of 20 percent or more decreased from 34 percent during the 2001–03 period to 29 percent in the 2003–05 period (data on average forgone earnings are not yet available). See http://www.bls.gov/news.release/disp.nr0.htm and http://www.bls.gov/opub/ted/2004/aug/wk1/art05.htm.
8. Jared Bernstein, *All Together Now: Common Sense for a Fair Economy* (Washington, DC: Economic Policy Institute, 2005).

American families face rising economic insecurity:

- Median wages are flat, while incomes have grown more volatile
- Unemployment lasts longer, but a smaller share of the jobless receive unemployment benefits
- Health care costs are up, while employer-provided health insurance is down
- Pension benefits are less certain

in the 1990s.[9] Unemployed low-wage workers are particularly unlikely to receive benefits.[10]

One of the most urgent sources of economic insecurity for many families is the rising cost of health care. As the cost of health insurance premiums have risen—from 8 percent of median family income in 1987 to 17 percent in 2003[11]—firms have cut back on their health benefits, leaving more and more Americans to fend for themselves. The share of the population with employer-provided health coverage declined from 64 percent in 2000 to 60 percent in 2005.[12] Even Americans with insurance are not immune to the risk of significant health care costs; 18 percent of insured working-age Americans are still paying off medical bills incurred in the past.[13] One recent study found that almost half of personal bankruptcy cases may be linked to medical causes.[14]

American families also face new uncertainties regarding their pensions, as American businesses shift risk to workers by moving from defined-benefit toward defined-contribution retirement plans.[15] In 1980, more than one-third of private workers were covered by a government-insured defined-benefit plan; by 2002, that fraction had declined to about one-fifth.[16] Defined-contribution plans such as 401(k)s provide less retirement security for two reasons: First, they are voluntary, mostly relying on worker contributions, and workers often fail to enroll.[17] Second, they are private investment accounts, uninsured by the federal government, and thus shift the risk and responsibility for proper financial planning onto the employees.[18]

This constellation of new and newly intensified economic risks—involving the changing nature of jobs, health care, and pensions—is reflected in Americans' general anxiety about their economic futures. For example, a majority of Americans report being "worried and concerned" about reaching their economic goals and believe that their children will be worse off than they are.[19] Only 34 percent said they believed that "most people can expect to better themselves, see rising incomes, find good jobs, and provide economic security for their families."[20]

9. U.S. Government Accountability Office, "Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited," GAO-01-181 (GAO, Washington, DC, March 2006), 12-13.
10. U.S. Government Accountability Office, "Unemployment Insurance: Factors Associated with Benefit Receipt," GAO-06-341 (GAO, Washington, DC, March 2006), 8.
11. Len M. Nichols, "Is an Individual Mandate Right for Louisiana?" Governor's Health Care Reform Panel, June 30, 2005, http://www.dhh.louisiana.gov/offices/publications/pubs-157/Nichols_LA_063005.pdf.
12. U.S. Census Bureau, "Income, Poverty, and Health Insurance Coverage in the United States: 2005,“ Current Population Reports, P60-231, August 2006, http://www.census.gov/prod/2006pubs/p60-231.pdf.
13. Sara R. Collins, Karen Davis, Michelle M. Doty, Jennifer L. Kriss, and Alyssa L. Holmgren, "Gaps in Health Insurance: An All-American Problem" (The Commonwealth Fund, New York, April 2006).
14. David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, "MarketWatch: Illness and Injury as Contributors to Bankruptcy," *Health Affairs* (February 2, 2005).
15. Whereas defined benefit plans provide employees with a guaranteed level of retirement income based on an employee's years of service, defined contribution plans, of which the most common form is the 401(k) plan, have employees contribute a share of their income to an individual account, while employers often contribute directly to such plans or match the contributions of employees.
16. David W. Wilcox, "Reforming the Defined-Benefit Pension System," *Brookings Papers on Economic Activity* 1:2006, 235-304.
17. Evidence shows a vastly higher participation rate in such plans when enrollment is automatic and workers have the chance to opt out, suggesting that the failure to enroll is usually not a determined choice. William G. Gale, Jonathan Gruber, and Peter R. Orszag, "Improving Opportunities and Incentives for Saving by Middle- and Low-Income Households" (Discussion Paper 2006-02, The Hamilton Project, Washington, DC, 2006). See also Brigitte C. Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116, no. 4 (2001): 1149–87; James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in *Tax Policy and the Economy*, ed. James M. Poterba, 16: 67–113 (Cambridge, MA: MIT Press, 2002).
18. Economic Policy Institute, "Issue Guide on Retirement Security" (2003), http://www.epi.org/Issueguides/retire/retirement_security_issue_guide-epi.pdf.
19. Peter D. Hart Research Associates and AFL-CIO, "Labor Day 2005: The State of Working America" (September 1, 2005), http://saveourcourts.civilrights.org/the_facts/details.cfm?id=35371; Edward Luce, "Blue-Collar U.S. Sees a Precarious Future," *Financial Times*, May 2, 2006.
20. Greg Anrig, Jr., "Creating a Softer Economic Cushion," (The Century Foundation, New York, July 17, 2006), http://www.tcf.org/list.asp?type=PB&pubid=572.

Economic Security and Economic Growth

Many policy makers and analysts have been trained to believe that providing more security to families must come at the expense of economic performance, and thus that these two goals are contradictory objectives.[21] Especially over the long term, however, this traditional view misses three key points:

First, a basic level of security frees people to take the risks—such as starting a business, investing in their own education, or trying an unconventional career—that lead to economic growth. With inadequate protection against downside risk, people tend to be overcautious, "fearing to venture out into the rapids where real achievement is possible," as Robert Shiller of Yale has argued. "Brilliant careers go untried because of the fear of economic setback."[22]

Second, if hardship does occur, some degree of assistance can provide the resources to help a family thrive again. Families with access to some form of financial assistance, educational and training opportunities, and basic health care are less likely to be permanently harmed by the temporary setbacks that are an inevitable part of a dynamic economy. For families experiencing short-term difficulties, a safety net can be a springboard to a better future and higher productivity.

Finally, and perhaps most importantly, a basic level of economic security can lessen political demands for growth-impairing policies such as protectionism. The benefits of new technology and competition tend to be spread widely across the economy, but are often highly disruptive to some specific industries or jobs. Individuals in the affected sectors may naturally resist the adverse effects on their own jobs associated with such overall progress; others may fear that they will be adversely affected, and resist the dynamic process that is associated with such risks. In this context, providing a basic level of economic security can ease transitions and help to avoid policy responses that may hamper overall economic growth.

Economic security can bolster economic growth by:

- freeing people to take risks and invest in their future (e.g., starting a business or furthering their education)
- helping families rebound from economic shocks
- lessening political demands for growth-impairing policies, such as protectionism

To be sure, providing too much security can harm economic growth by excessively blunting incentives to work, innovate, and invest, and some developed nations have gotten the balance wrong in this way. But any such adverse effects on growth can be as much a matter of *how* economic security is provided—and, in particular, whether policy design pays careful attention to incentives—as *how much* security is provided. Policy makers, therefore, must seek the right balance, recognizing that both the form and the amount of economic security can affect economic growth and individual well-being.

21. As one leading textbook observes, "As the government insures individuals against being poor, it raises the incentive for individuals to be poor." (Jonathan Gruber, *Public Finance and Public Policy* [New York: Worth Publishers, 2004], 463.)
22. Robert Shiller, *The New Financial Order: Risk in the 21st Century* (Princeton, NJ: Princeton University Press, 2003), 8. Senator Barack Obama (D-IL) has made a similar point, arguing that "these safety nets are exactly what encourage each of us to be risk-takers and entrepreneurs who are free to pursue our individual ambitions. … We take a chance on start-ups and small businesses because we know that if they fail, there are protections available to cushion our fall. Corporations across America have limited liability for this very reason. Families should too—and that's why we need social insurance." (Barack Obama, "A Hope to Fulfill" [remarks prepared for luncheon at the National Press Club, Washington, DC, April 26, 2005].)

A Strategy to Enhance Economic Security

The Hamilton Project's strategy for strengthening economic security in a growth-enhancing manner begins with two key components: better preparation before economic difficulties arise, and better-targeted and more pro-work assistance after economic difficulties arise. In the coming months, the Project also will advance a broader set of options, including policies to improve health security, that are designed to strengthen the social safety net and help families manage economic risk both before and after difficulties arise.

Better Preparation Before Economic Difficulties Arise: Saving and Education

Higher private saving and quality education can better prepare families for periods of economic difficulty, while boosting long-term economic growth. Saving and asset accumulation give families a cushion when shocks hit. A recent discussion paper released by The Hamilton Project argues that saving could be significantly increased through relatively simple changes. It argues that, under the existing approach to 401(k)s and Individual Retirement Accounts (IRAs), busy families who cannot focus adequately on saving decisions wind up not saving, and that tax incentives to save for many middle- and low-income households are weak. In response, the proposal would require firms to automatically enroll their new workers in a traditional defined benefit plan, a 401(k), or an IRA; workers could opt out of the 401(k) or IRA if they chose. It would also replace the existing "upside down" set of tax incentives for retirement saving—incentives that tend to subsidize asset shifting by higher-income households rather than new saving by middle- and lower-income households—with a simple 30 percent match for everyone, thereby strengthening the incentive to save for 80 percent of all households.[23]

This approach to asset accumulation differs dramatically from the approach implied by you're-on-your-own economics. Rather than focusing saving incentives on the middle-class and on lower-wage earners, the you're-on-your-own approach would direct the bulk of new incentives toward those who already save significant amounts. One common proposal, for example, would increase the maximum amount that can be saved on a tax-preferred basis, such as by raising the amount that can be contributed to an IRA or a 401(k). Yet fewer than 10 percent of 401(k) participants, and about 5 percent of those eligible to contribute to IRAs, make the maximum contribution allowed by law. Simply increasing the maximum contribution amounts would have no effect on the vast majority of families and individuals who currently face no bar against making further contributions. Instead, raising the contribution limits would largely provide windfall gains to households that already make the maximum contributions to tax-preferred accounts and save additional amounts in other accounts. Most of the response to higher contribution limits likely would be a shifting of assets from ordinary accounts to tax-preferred accounts. The expanded tax preference thus would mostly subsidize saving that would have occurred anyway, rather than encourage new saving. As a result, if the expanded tax preferences were deficit financed (i.e., through government borrowing), the subsidies might well lead to a reduction rather than an increase in net national saving. Thus, these policies would fail to improve either household preparation for adverse economic shocks or social equity, and could even reduce net national saving.

23. Gale et al., "Improving Opportunities and Incentives." This idea has also been championed by Gene Sperling in *The Pro-Growth Progressive: An Economic Strategy for Shared Prosperity* (New York: Simon & Schuster, 2005).

Workers can better prepare for economic adversity not only through asset accumulation, but also through education. Better-educated workers are not only more productive on average; they are also better able than less-educated workers to cope with job loss and other economic shocks. For example, more-educated workers spend less time without work after displacement, and when they do return to work, better-educated workers are more likely to find full-time rather than part-time employment, become reemployed at earnings levels that compare favorably to those on their former job, and replace employer-sponsored health plans lost with their prior job.[24] The income volatility faced by workers with at least some college education is substantially lower than that faced by workers who did not finish high school.[25]

The Hamilton Project has already released two discussion papers to improve education; it will release more in the future.[26] One paper argues that teacher quality could be improved significantly by placing less emphasis on teacher credentials at the time of hiring and more emphasis on teacher effectiveness while on the job. This proposal is supported by research suggesting that qualifications such as teacher certifications provide almost no information about which applicants will prove to be the most effective teachers. Adopting the proposal would result in a larger number of teachers being hired each year—some with and some without certification—but a more rigorous filter—involving performance on the job—for those teachers to receive tenure. Most importantly, increasing teacher quality could have a significant effect on student achievement. The other discussion paper calls for Summer Opportunity Scholarships so that economically disadvantaged children can attend summer school or a summer enrichment program. This proposal is supported by research documenting summer learning loss, in which children from disadvantaged families, who have fewer opportunities for summer enrichment, experience greater losses in skills during summer vacations than do their more advantaged counterparts; these effects tend to cumulate over many summers.

Better-Targeted and More Pro-Work Assistance After Economic Difficulties Arise

Although greater saving and more education can improve economic security, they are not a panacea. The rate of involuntary job loss for workers with a college degree, for example, is more than one-third lower than the rate for workers without a high school degree; nonetheless, those with college degrees face a three-year job loss rate of about 10 percent.[27]

It is therefore critical to devise market-friendly ways to help families and workers deal with economic difficulties. Effective programs must strike a difficult balance. As noted above, providing too little assistance not only can directly inhibit risk-taking and productivity, but also can trigger a backlash against policies that are broadly beneficial yet impose concentrated costs on specific firms or industries; at the same time, assistance must be designed to avoid creating harmfully distorting incentives that impair overall growth. The easier cases involve programs in which incentives are likely not a strong influence on behavior.

The harder cases, in which the need for balance is most critical, involve programs that provide crucial insurance but also may have significant incentive effects, such as programs that affect decisions to work and save. An example is the nation's unemployment insurance (UI) system. The innovation, competition, and shifts in business practices that fuel the dynamism of the American economy also create a turbulent labor market with substantial turnover. On an average day in 2005, for example, about 3.7 million people who had lost their jobs through no fault of their own were unemployed and actively looking for work. The current unemployment insurance system helps cushion the shock of job loss and facilitate reemployment by providing limited income support for up to six months to workers who become unemployed through no fault of their own. However, the system has not been significantly updated since it was created 70 years ago, while the labor market has changed dramatically around it.

24. Paul Swaim and Michael Podgursky, "Do More-Educated Workers Fare Better Following Job Displacement?" *Monthly Labor Review* August (1989), 43; Steven Hipple, "Worker Displacement in the Mid-1990s," *Monthly Labor Review* July (1999): 15; Karen Needels, Walter Corson, and Walter Nicholson, "Left Out of the Boom: UI Recipients in the Late 1990s" (report submitted by Mathematica Policy Research, Inc. to the Department of Labor, October 2001), 74.
25. Hacker, "Universal Insurance."
26. Robert Gordon, Thomas J. Kane, and Douglas O. Staiger, "Identifying Effective Teachers Using Performance on the Job" (Discussion Paper 2006–01, The Hamilton Project, Washington, DC, April 2006); Molly E. Fifer and Alan B. Krueger, "Summer Opportunity Scholarships: A Proposal to Narrow the Skills Gap," (Discussion Paper 2006–03, The Hamilton Project, Washington, DC, April 2006).
27. Farber, "What Do We Know About Job Loss?," p. 21. See Figure 2, "Three-year job loss rate by education, 1981–2003."

The Hamilton Project is releasing two discussion papers that take rather different approaches to restructuring UI. The release of two papers on the same topic underscores the project's role in stimulating serious debate on important economic issues; policy makers would not implement both proposals.

Jeffrey Kling of the Brookings Institution notes that the current system offers no assistance to workers who become reemployed at a lower wage and face significantly lower lifetime earnings—which occurs for about one-third of people who take new jobs after being laid off.[28] Kling proposes a fundamental restructuring of the unemployment insurance system: Wage-loss insurance would provide long-term assistance to laid-off workers who are subsequently reemployed at lower salaries; a newly created borrowing mechanism and system of self-funded accounts would assist workers during periods of unemployment. This proposal, Kling argues, would better protect workers against the long-term effects of involuntary unemployment, better target benefits toward those who most need assistance, and encourage reemployment. Kling's budget-neutral reform would provide help to workers coping with the longer-term hardships against which they are least able to protect themselves. If adopted, the new system would cut in half—from 14 percent to 7 percent—the share of laid-off workers who experience very large drops in earnings at their new jobs.

An alternative approach to reforming the unemployment insurance system is described in a discussion paper by Lori Kletzer of the University of California at Santa Cruz and the Institute for International Economics and Howard Rosen of the Institute for International Economics and the Trade Adjustment Assistance Coalition. Kletzer and Rosen believe that UI should remain focused on providing assistance during short-term periods of unemployment. To make UI more responsive to a labor market that has changed substantially since the program was created in 1935, Kletzer and Rosen propose three broad changes to UI. First, they would establish national standards regarding the level and duration of UI benefits, program eligibility (expanding eligibility to include part-time and seasonal workers and reentrants to the labor force), and program financing (raising the maximum federal taxable wage base). Second, they would allow self-employed workers, and perhaps others, to make a limited amount of tax-favored contributions to newly created personal unemployment accounts. Contributions would be matched by the federal government. Funds could be withdrawn later to cushion severe economic loss or to pay for training or a job search. Finally, Kletzer and Rosen propose supplementing UI with a wage-loss insurance program that would offset some of the earnings lost by those who are laid off and then reemployed at lower wages. Together, these changes would cost more than $10 billion a year; financing would come from a combination of payroll taxes and general revenues.

Both papers recognize the need to reform UI and to add a wage insurance component. A significant difference between them, though, is the relative emphasis on long-term protection against reduced wages. Kling believes that this should be the focus of a system to help displaced workers, whereas Kletzer and Rosen hold that short-term income support during the period between termination and reemployment should continue to be the mainstay of a comprehensive unemployment system. In addition, the Kling proposal would be revenue neutral, while the Kletzer-Rosen proposal would increase funding for UI and related programs.

A third discussion paper released by The Hamilton Project considers broader changes in how the nation could address economic security. Jacob S. Hacker of Yale University proposes the creation of Universal Insurance focused on providing temporary and partial relief from severe economic shocks. This Universal Insurance program would be available to nearly all American families. To limit potential incentive problems and to target relief effectively, Hacker's proposal would provide only fractional and temporary insurance and would only be triggered if certain qualifying conditions were met, and if family income suddenly declined by more than 20 percent or out-of-pocket health costs exceeded 20 percent of income. Although most families would be eligible, the program would be most generous for lower-income families, which have the fewest resources of their own. Hacker estimates that his proposal would reduce by half the risk of a family income decline of 50 percent or more. He argues that this type of insurance—covering a range of risks but limited to particularly dramatic cases to minimize incentive problems—is likely to provide a stronger platform for enhancing economic security in a world of rapidly changing risks than the current fragmented collection of categorical programs. As the nation struggles with the consequences of increased income volatility, this proposal should be actively debated along with other potential policy responses.

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28. Jeffrey R. Kling, "Fundamental Restructuring of Unemployment Insurance: Wage-Loss Insurance and Temporary Earnings Replacement Accounts" (Discussion Paper 2006–05, The Hamilton Project, Washington, DC, September 2006).

Future Policy Proposals

In the near future, The Hamilton Project will release additional discussion papers containing options designed not only to enhance the economic security of American families, but also to make it more likely that the benefits of economic growth are once again shared more broadly. In 2007, the Project will release a number of options to improve health security and to build a more-educated workforce. The health-care proposals will include both broader reforms of the health-care system and more targeted proposals to address issues in specific health sectors. In addition to proposals that will directly influence economic security, the Project will be releasing a variety of other discussion papers on topics such as technology and infrastructure that are intended to bolster economic growth and productivity.

The Hamilton Project's strategy for strengthening economic security in a growth-enhancing manner has two components: better preparation before economic difficulties arise, and better-targeted and more pro-work assistance after economic difficulties arise.

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