

Responses to Questions about

“Fundamental Restructuring of Unemployment Insurance: Wage-Loss Insurance and Temporary Earnings Replacement Accounts”

Hamilton Project Discussion Paper 2006-05.

http://www1.hamiltonproject.org/views/papers/200609kling_wp.htm

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- Does this proposal shift the burden of financing unemployment benefits from employers to workers?

The proposal would maintain employer contributions to the restructured system at current levels. To provide more funds to those who most need assistance while maintaining budget neutrality, some workers would receive larger net transfers under the proposed system, and some would receive smaller net transfers. Funding would be shifted to increase funding for individuals who have suffered large wage losses (through wage-loss insurance) and to reduce funding for individuals experiencing temporary layoffs or those who return to work at higher wages. In order to maintain living standards during the six months after job loss at the same levels as the current system, temporary earnings replacement accounts would allow workers to draw upon savings or to borrow against future earnings to have sufficient cash availability.

- Would wage-loss insurance reduce wage levels and subsidize low-wage employers?

The purpose of wage-loss insurance is not to encourage individuals to accept jobs with lower wages, but to provide additional income to individuals who were going to accept jobs anyway that had wages lower than their previous job. One-fourth of those permanently laid off had wages at least 25 percent lower than their previous job without any wage-loss insurance.

Evidence from tax rate changes and from demonstration projects including the negative income tax experiments and the Canadian Earnings Supplement Program do not provide significant evidence suggesting the availability of wage-loss insurance payments would lead individuals to choose jobs with lower hourly wages than they would in the absence of wage-loss insurance. The wage-loss insurance in this proposal is based on hourly wages, providing no incentive to work fewer hours as was observed with the annual income subsidies of the negative income tax experiments. (See pages 23-26 of the discussion paper). Increases in total labor supply from wage-loss insurance may reduce wage levels, in the same manner as any other policy that

successfully encourages work. The effect on labor supply is likely to be small, and the effect on wages is likely to be small in magnitude as well.

Any effect on wages from increased labor supply is not the same having the employer capture a government subsidy for themselves. It would be difficult in most cases for an employer to game the system by paying a worker an artificially low hourly wage in order to increase wage-loss insurance payments, because some of the firm's new hires would not be displaced workers and two pay rates would be needed for the same type of work. The gaming would be perceived as inequitable, transparently visible to many employees, and easily auditable if investigated. This is especially true in a large firm with a human resources department and established position descriptions and pay scales. (See page 29 of the discussion paper).

- What is the evidence that workers and society would not be better off if the worker had waited for a job match where productivity and wages would be higher?

Switching from traditional UI to TERAs would reduce net transfer payments made to those with temporary layoffs or those with unemployment spells followed by wage gains. For these groups, the switch to TERAs is somewhat similar to the difference between receiving higher or lower UI benefits. The evidence on the link between higher UI benefits and wages upon re-employment is mixed, and does not clearly indicate that increasing UI benefits leads to higher wages or higher productivity even though it clearly increases unemployment duration. (See pages 24-25 of the discussion paper).

There is evidence that when searching for a job, the unemployed place emphasis not only on the current market valuation of their skills, but also on how wage offers compare to their previous hourly wages. The availability of wage-loss insurance may help people overcome this psychological hurdle and more quickly accept the reality of prevailing market wages and help avoid prolonged unemployment that can further depress wage offers – such as when longer duration is perceived as a negative signal by employers, when individuals become discouraged and reduce search effort, or when their skills deteriorate. (See page 25 of the discussion paper).

- How is this proposal related to requests for unemployment insurance waiver authority?

The Administration's May 3, 2006 request for waiver authority gave suggestions of potential uses of waivers, but was not concrete or specific. In contrast, this proposal presents a clearly defined plan to shift the resources of our system towards insurance for persistent, long-term effects of job loss and to increase the share of benefits received by the lower half of the income distribution. The proposal would help reduce significant hardship.

- Would wage-loss insurance move workers into jobs they would not otherwise take while producing employment losses for workers who would otherwise find those jobs?

The introduction of wage-loss insurance is anticipated to reduce unemployment duration for those with wage losses by a small amount, and not projected to result in lower wages upon re-employment. In this proposal, the wage-loss replacement rate of 25 percent, the lack of a short time limit (e.g. two years since displacement) on payments, and flexibility to receive wage-loss insurance for any work (rather than only for full-time work) make the employment incentives more modest than most other wage insurance proposals, and emphasize the primary purpose of providing insurance payments to increase the lifetime income of those with large wage losses who are hit hard by permanent job loss.

Davidson and Woodbury (1995) conducted a simulation of what might happen if wage-loss insurance were introduced into their model of the economy, but there is no actual empirical evidence of any impacts on non-recipients of wage-loss insurance.¹ If unemployment durations for those with wage-losses do decrease, then unemployment durations for others with skills similar to displaced workers (such as new labor market entrants) may increase, but total unemployment duration of all groups combined is anticipated to decrease. With increased search intensity among those with wage-losses, the total number of jobs and the total output of the economy may be likely to be higher, with this increased economic growth reducing any impact on the unemployment durations of other groups.

- Would wage-loss insurance discourage the upgrading of skills through reduced use of public training programs or reduced prevalence of on-the-job training?

Since wage-loss insurance is not anticipated to cause recipients to be employed at jobs with lower wages, any impact on types of jobs and on associated on-the-job training is likely to be negligible. The use of public training programs during unemployment is likely to be reduced as unemployment durations are shorter, offset in part by reduced depreciation of skills during the shorter unemployment spell. The wage-loss insurance in this proposal accommodates part-time employment, and it does not discourage individuals from attending community colleges or participating in other skill-enhancing off-the-job training while working.

¹ Davidson, Carl and Stephen A. Woodbury. "Wage-Rate Subsidies for Dislocated Workers." Upjohn Institute Staff Working Paper 95-31, January 1995 <http://www.upjohninstitute.org/publications/wp/95-31.pdf>

The wage-loss replacement rate is one-half, and the duration is up to two years in this simulation. They write that "The results suggest that a wage-rate subsidy paid for two years after reemployment would shorten the unemployment spells of dislocated workers by nearly 2 weeks, and would increase employment of dislocated workers by about 900 to 1000 per 100,000 in the labor force. But the simulations also raise the possibility that the gains for dislocated workers could come at the expense of other groups of workers; that is, other groups of workers could experience small increases in unemployment duration, and decreases in employment levels that almost fully offset the gains for dislocated workers. Three factors may mitigate these crowding-out results -- crowding out is widely dispersed over various groups of non-dislocated workers, the structural changes that result in dislocation of some workers (and drive the need for a policy like a wage subsidy) benefit non-dislocated workers, and the crowding-out results are quite sensitive to one of our assumptions ... that the total number of available jobs (T) is fixed and exogenous." That is, the simulation assumes there cannot be any economic growth.