

# Policy for Displaced Workers: Retraining or Wage Insurance?

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## Policies for Displaced Workers

- Who?
  - Individuals with good job histories who have been laid off.
    - Substantial tenure with prior employer.
    - Not necessarily currently unemployed.
    - NOT ECONOMICALLY DISADVANTAGED.
  - Risk of large, permanent reemployment earnings losses.
- What?
  - Passive policies: unemployment benefits ...
  - Active policies: retraining, referrals, job search assistance.

## Why Aid Displaced Workers?

- Market failures:
  - Capital markets imperfect:
    - Hard to borrow using human capital as collateral.
  - No private market insures against risk of displacement.
    - Like having your home burn down w/o insurance.
    - Public sector also does not provide this insurance.
  - Mollify opposition to public policies likely associated with job loss.
    - E.g., TAA as a response to trade liberalization.

## The “Costs” of Job Loss

- Fewer Hours Worked:
  - Workers are unemployed
  - Involuntarily employed part-time.
- Lower Wages:
  - Workers new jobs pay less than their old jobs.
- Workers with substantial tenure are displaced:
  - Lower Wages >> Fewer Hours Worked

## Job Creation and Destruction

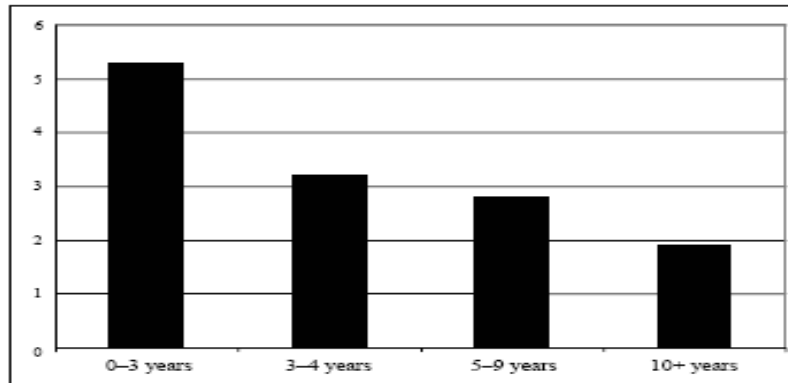
- Persistent feature of a flexible labor market.
  - In the U.S. ~ 20% of “jobs” are created or eliminated, annually.
- Essential complement to technological innovation and changing trade patterns.
- After a period of unemployment & adjustment most workers find jobs that pay as much as their old jobs. ...

## Incidence of Job Displacement

- About 4% of U.S. Labor Force, every two years.
- Most unemployed for < 6 months
- Substantial share unemployed < 5 weeks.
- Most find new jobs that pay similarly to their old jobs.
- Most displaced workers had little prior tenure.

## “Displacement” is More Common for Low Tenured Workers

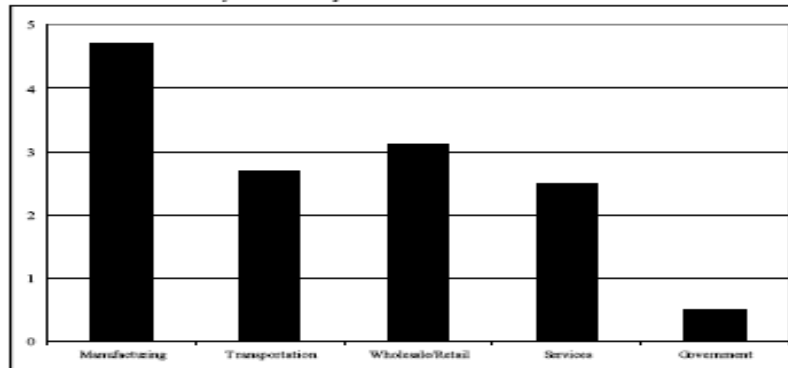
Figure 3: Percentage of Workers Displaced by Years of Job Tenure Between 1999–2000



Source: Monthly Labor Review, June 2004.

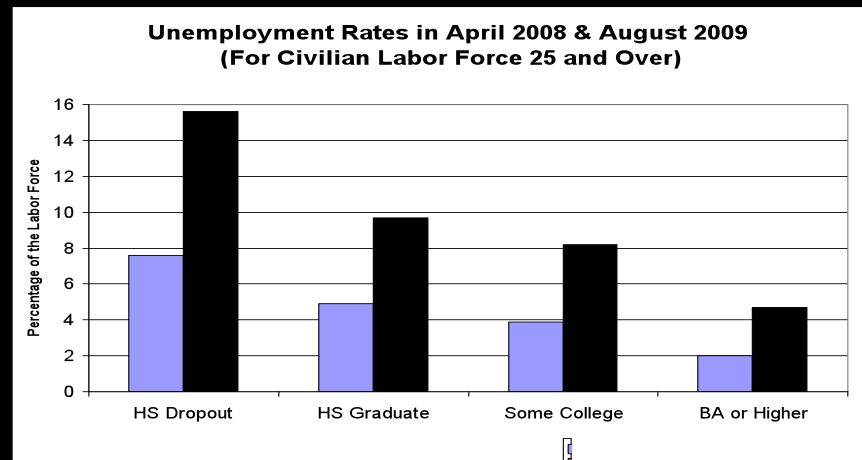
## Risks for Workers in Service Sector

Figure 4: Two-Year Displacement Rates for Long-Tenured Workers by Selected Major Industries Between 1999–2000



Source: Monthly Labor Review, June 2004.

## Who Are the Unemployed?



## Some are Permanently Harmed

- Prime-aged workers with strong employment histories are, on average, permanently harmed by job loss.
  - They are unlike other targets of government employment programs.
  - The “hit” is like having one’s house burn down, ... without insurance.
  - Easy to see with longitudinal data.

## From Jacobson, LaLonde, & Sullivan (2005): Washington State

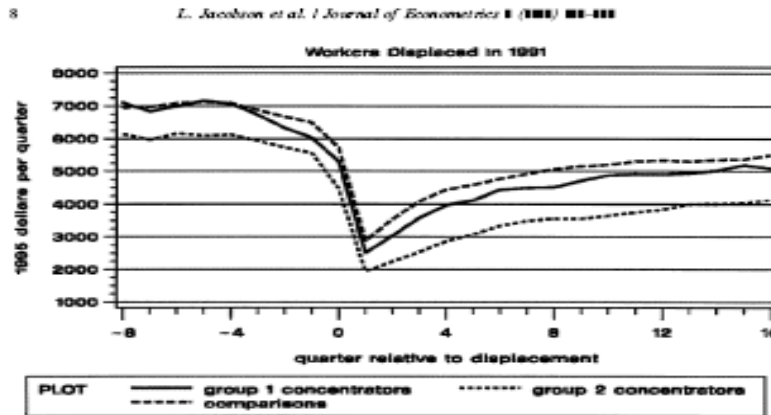
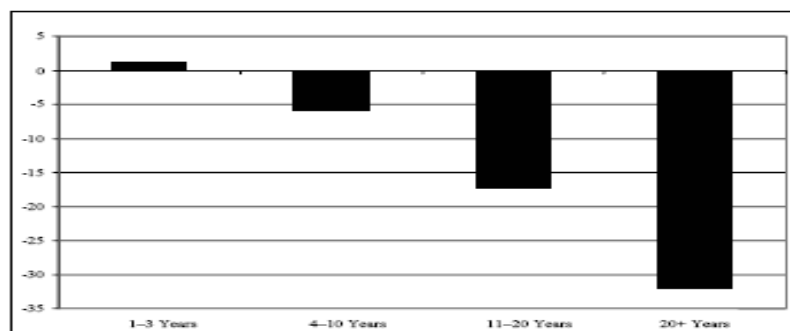


Fig. 1. Earnings of trainees and comparisons.

## From Farber (2004): Displaced Workers Surveys

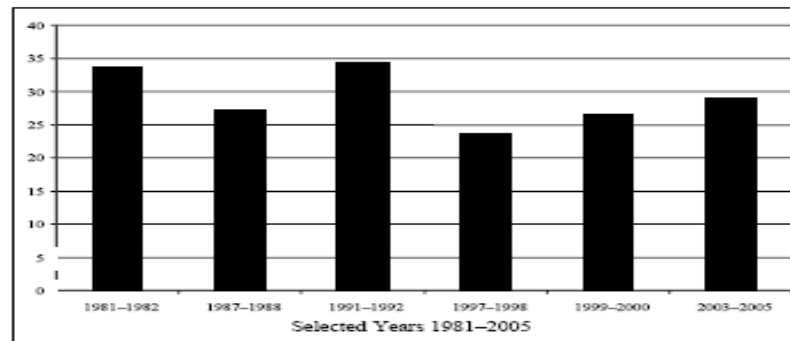
Figure 1: Percentage Difference Between Wages Post- and Pre-Displacement, by Tenure with Pre-Displacement Employer



Source: Author's calculations using Henry Farber (2004), Table 3, page 24, based on calculations from the U.S. Bureau of the Census 2002 Displaced Worker Survey.

## A Significant Percentage of Displaced Workers Lose Big Even in Good Times

Figure 2: Percentage of Long-Tenured Displaced Workers with Earnings Losses Greater Than 20 Percent



Source: Author's calculations using Henry Farber (2004), Table 3, page 24, based on calculations from the U.S. Bureau of the Census 2002 Displaced Worker Survey.

## Option #1: Training and Employment Services

- Long history of providing very basic training to the economically disadvantaged
- Sporadic history for displaced workers
  - Original target group of Area Redevelopment Act and Manpower Development & Training Act.
  - Emphasis changed when OEO established
  - Deemphasized under JTPA.
  - Gradually increased efforts under Title III.
- State and local governments increasingly provide through community colleges.

## Who Gets Training?

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- Private sector training goes disproportionately to the highly skilled.
- Community college “retraining” goes disproportionately to those with at least some prior college education.
- Women get more CC retraining than men.
  - Take different kinds of courses.
- Participation declines with age.

## Consistent With Economic Theory

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- Participate in retraining if the private benefits > private costs.
- Seek Retraining if:
  - Earnings gains are large
  - If plan to work long enough to justify costs
  - If direct costs are low
  - If indirect (opportunity costs) are low.
- See these patterns in Washington State data



Table 1. Continued

**B. Participation Rates and Community College Credits Completed by Displaced Workers**  
 (credits accumulated in Washington State community  
 colleges by workers displaced between fall 1989 and 1995)

All Credits:	Rate <sup>a</sup>	Mean <sup>b</sup>	Std. Dev. <sup>c</sup>	Number of Completed Community College Credits (Fraction)					
				1-5	6-10	11-20	21-40	41-75	75+
Men under 35	.168	29.5	33.3	.27	.16	.16	.15	.13	.13
Men 35 and over	.109	27.4	34.0	.33	.16	.16	.12	.11	.12
Women under 35	.235	27.3	32.3	.32	.17	.15	.14	.12	.12
Women 35 and over	.172	23.5	30.8	.39	.16	.14	.11	.10	.10

## Does Community College Retraining Work?

- Community Colleges generate “normal” returns.
  - Not necessary to acquire a credential.
  - Must be true for older, especially male, displaced workers.
- Lots of heterogeneity in impacts by courses, skills, and gender.
  - Unskilled likely cannot benefit.
- Participation patterns are consistent with these “impacts.”
- Old dogs can be taught new tricks, ...
  - but are the worth it?

## Long-term Impact on Quarterly Earnings Per C.C. Credit

Gender/ Age Group	All Courses	Group 1 Courses	Group 2 Courses
Males < 35	<b>\$9.10</b>	<b>\$12.10</b>	<b>\$5.80</b>
Males > 35	<b>\$8.90</b>	<b>\$12.40</b>	<b>\$4.20</b>
Females < 35	<b>\$12.10</b>	<b>\$23.70</b>	<b>\$5.50</b>
Females > 35	<b>\$9.60</b>	<b>\$18.50</b>	<b>\$4.30</b>

## Estimated Percentage Impact of 1 Year of Courses on Earnings

Gender/ Age Group	All Courses	Group 1 Courses	Group 2 Courses
Males < 35	<b>7.7%</b>	<b>10.2%</b>	<b>4.9%</b>
Males > 35	<b>5.5%</b>	<b>7.8%</b>	<b>2.6%</b>
Females < 35	<b>12.9%</b>	<b>25.3%</b>	<b>5.8%</b>
Females > 35	<b>8.7%</b>	<b>16.9%</b>	<b>3.9%</b>

## Have Not Included “Networking Effects” of Community College

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- “Just Showing Up” Effects.
- Washington State Estimates Per Quarter:
  - Males < 35: \$109
  - Males > 35: \$148
  - Females < 35: -\$76
  - Females > 35: \$72
- Imprecise estimates
- Might add 2.5% points to SRI for men.

## How Much Investment is Needed?

- The Unskilled?
  - *Not clear what to do with this group!*
  - 40 years of evaluation ...
  - Supported Work/Public Employment?
- Some college education or more:
  - *Clear net benefits for individual and society!*
  - 3 years full-time retraining will off set losses.
  - Cost = direct + indirect ~\$100,000.

## Expanded Training Very Unlikely to Mollify Workers Fears of Job Loss

- Consider this retraining program.
  - Provide \$10,000 in retraining.
  - Assume it “works.”
  - Participant does not work while in training.
  - Participant could earn \$30,000 per year.
- Given 50 years of research on education and training programs, expect earnings to:
  - Increase by ~ \$4,000 per year.

## Can We Expect a Good Program to Work Better?

- NO!
- Why?
- Suppose a program claims to make \$30,000 a year workers \$50,000 a year workers.
- This implies a rate of return of:
- What about giving displaced workers \$\$\$?

## Adjustment Assistance for Displaced Workers

- Compensating losers has a long history.
- Suggested in U.S. Council of Foreign Relations working paper during WWII.
- U.S. Policies:
  - Trade: Trade Expansion Act – 1962
    - Trade Acts of 1974 and 2002/ NAFTA-TAA
  - Technology: Manpower Development and Training Act – 1962
    - Amendments to JTPA during 1990s.

## Why Aid Long-Tenured Displaced Workers?

- Allays well-founded fears of job loss.
- Market failure:
  - Adverse selection
  - Moral hazard
- Government should mitigate the adverse effects of its policies:
  - Trade liberalization
  - Environmental policy
  - Infrastructure investments

## Parameters of Standard Wage Insurance Proposals

- Workers must earn < \$50,000 per year.
- Annual Benefits: Capped at \$10,000.
- Duration of Benefits: 2 years.
- Replacement rate when employed: 50% of earnings losses.
- Annual Expenditure: \$3 to \$4 billion
- Financed by: \$2 to \$3 tax per month on workers' wages.

## Limited Experiments

- US: Alternative TAA program.
- Canada: Social experiment.
  
- Do either of these examples help us understand benefits of wage insurance to workers most at-risk?

## The Effects of Standard Wage Insurance Proposals

Months	Earnings	Earnings if Displaced			Earnings under Standard Displacement Insurance Proposals		
		Earnings	Benefits	Income	Earnings	Benefits	Income
0-6	20,000	6,346	5,385	11,731	8,077	5,577	13,654
6-12	20,000	15,000	0	15,000	15,000	2,500	17,500
12-18	20,000	15,000	0	15,000	15,000	2,500	17,500
18-24	20,000	15,000	0	15,000	15,000	2,500	17,500
2-Year Totals	80,000	51,346	5,384	56,730	53,077	13,077	66,154
3-4 Year Totals	80,000	60,000	0	60,000	60,000	0	60,000

## Problems with Current Proposals

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- If goal is lessen well-founded fears of costly job loss ...
- The poor or working poor are NOT the target population for a well-designed program.
- Low earnings thresholds undermine the policy.
- Wage insurance is NOT anti-poverty policy.

## Design Flaws:

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- Tenure restrictions.
- Length of payments.
- Earnings thresholds.
- Low caps.
- 50% replacement rate?
- Lump Sums?
  - Good incentives
  - Bad evidence, blunt instrument, impractical



## Cost of Wage Insurance

- Current proposals: \$3 to \$4 billion or 10% of UI expenditures.
  - For 2 years of payments.
  - Additional \$2 billion or another 2 years.
- Small # of those who benefit are long-tenured prime-aged workers.
- Retarget these \$\$\$.

  - Modest deductables on reemployment losses.

## An Example: Old Job Earnings Was \$80,000 & 25% Earnings Loss

Months Since Job Loss	Post Job Loss Earnings	Total Benefits	Income	Total Loss
0 to 6	16,150	8,190 (2,690)	24,340	15,660
7 to 12	30,000	5,000	35,000	5,000
13 to 18	30,000	5,000	35,000	5,000
19 to 24	30,000	5,000	35,000	5,000

## Real Wage Insurance is Expensive

- (1) First year covered by current proposals.
- (2) Second year not covered.
- (3) Subsequent years not covered.
- (4) “Real” Wage Insurance Payments:
  - 40 year old ~ \$247,690
  - 50 year old ~ \$147,690
  - 60 year old ~ \$47,670

## “Deductibles”

- On the first 5% points of losses.
  - 40 year old ~ \$247,690 → \$222,920
  - 50 year old ~ \$147,690 → \$132,920
  - 60 year old ~ \$47,670 → \$42,920
  - Will also reduce #s eligible for payments.
- Prior tenure restrictions.
  - Reduce numbers eligible.
  - Or tie payment replacement rate to prior tenure.

## Program Administration

- Amend the U.S. Social Security Act.
- Allow states to operate program as they do the UI program.
- Use quarterly wage reports by employers:
  - Some accounting for movements across state lines.
  - Establish employment tenure.
  - Establish tenure with a primary employer.
- Require all workers to set up IRA and contribute 1% of before tax earnings annually.
  - Self insure increased waiting periods for UI.
  - In six years covers 6 week waiting period.

## Financing a Better Policy

- Raise UI taxes.
- Divert \$1 Billion + from retraining.
- Divert \$1 Billion from TAA.
- Increase waiting period.
  - 1 extra week raises \$1.9 Billion
- Proposal: 6 week waiting period raise ~ \$8 to \$10 billion.
  - Shift UI from temporary to permanent losses.
  - Shift away from loses that workers can self-insure.
  - In keeping with the idea of high deductibles.

## The Politics?

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- Raising UI Taxes.
- Increasing the waiting period.
- The small # of targeted recipients.
- Diverting TAA & WIA dollars.
  - Why should policy makers “ earmark ” dollars for retraining for prime aged workers?
  - If workers want they can use payments to invest in retraining themselves.

## Current Policy Offers the Losers Peanuts!

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- TAA ~ \$1 billion
- WIA – Adult Activities ~ \$1 billion
  - Reemployment services (no help at all!)
  - Retraining
- Lower product prices and more goods.
- Estimated gains from liberalized trade:
  - \$1 trillion.
- Estimated gains from Technological Change:
  - \$ ??? trillions!

## Fostering the Public's Support for a Dynamic Economy?

- Purpose of wage insurance ...
- Well designed policy \$15 billion?
  - Provides life-long benefits for prime-aged long-tenured displaced workers.
  - Targets the big losers.
  - Targets all big losers w/o regard to cause.
- Current policy is like an auto-insurance policy that covers only fender benders.

## Conclusions

- For an important minority, job loss and unemployment are associated with large long-term income losses.
- Current policy provides little protection.
- For older workers training won't work,
  - Especially for the unskilled.
- Meaningful wage insurance, preserves the training option, and protects workers from this risk.

## Economics?

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- How does policy affect concession bargaining by unions?
  - Issue not likely important in the U.S.
  - Private sector union density ~ 8%.
- How does wage insurance affect retirement decisions and interact with social security?

## More Research is Needed

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- Little is known about retraining decisions and benefits of retraining for adults.
- Substantial heterogeneity in effects.
  - By prior skills.
  - By types of courses.
  - By labor market
- Networking effects of community college
- Administrative data exists.

## **My Pitch to Encourage More Use of Administrative Data**

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- (I) Quarterly wage records.
- (II) community college transcript records.
- (III) Unemployment insurance claims records.