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## The Deficiencies of the Unemployment Insurance System:

What are the Alternatives?

Oren M. Levin-Waldman

The first line of defense for workers laid off from their jobs has been Unemployment Insurance (UI). Each state establishes a trust fund financed through premiums levied against employers. Unemployed workers usually receive benefits for an average of 26 weeks, and only if their unemployment is of no fault of their own. They must also show that they have been looking for reemployment. But herein lies the problem. The system, as it was designed, assumes that layoffs will be temporary and that in most cases workers will be recalled to their employers. Therefore, the system was designed to provide temporary assistance to tide workers over until they would be recalled. It wasn't designed to assist them with transitions, from one type of labor to another. But with deepening recessions over the years, downsizing, and more and more plant closures resulting in greater permanent displacement, the UI system has increasingly found itself strained. For one thing, it isn't entirely clear that the reserves exist to provide for all the unemployed. During times of recession, state trust funds haven't always proved to be adequate, and states over the years have had to borrow funds from the U.S. treasury.<sup>(1)</sup> Moreover, a system initially designed to ensure short-term income maintenance is ill-equipped to meet the needs of a dislocated workforce which needs assistance in making transitions. As the UI system was an outgrowth of the disruption caused by industrial production, it would seem that UI needs to be reformed so that it can better meet the needs of an economy in transition -- from industrial to post-industrial or from production to information.

The changing nature of the global economy does raise the question as to whether an unemployment insurance system can do more for displaced workers than simply providing them with income maintenance. Should the system provide retraining? Could the money which is paid out as benefits be put to better use? But the fact that the system may be inadequate for today's economic realities by no means obviates the need for income maintenance by those who are displaced? The question is what more can the system do for them than simply tiding them over until they find new jobs? Could it assist them in starting their own businesses by providing their benefits in one lump sum? Or could the money be channeled towards training efforts? And yet, the question of whether UI money could be better spent another way hinges on the assumption that unemployed workers don't necessarily use the money properly. Or that they wouldn't need it if they would only make a more concerted effort to find jobs, which they don't feel compelled to do because the system has afforded them the luxury of leisure time over the imperative of job search. The system, then, immunizes workers against the vagaries of the market place at a social cost. This notion is actually consistent with the literature on unemployment insurance. But at the same time, it may well miss the point. As much as economic models can explain individual behavior in terms of incentives and disincentives, it isn't entirely clear that these models understand the true nature of unemployment. Unemployment isn't homogeneous.<sup>(2)</sup> Moreover, unemployment does more than simply cause a disruption in people's income which can be partially compensated through UI benefits. It causes disruption in the structure and fabric of their lives which cannot be compensated no matter how generous the provision.<sup>(3)</sup> The purpose of this paper is to examine the current system of Unemployment Insurance in the U.S. and explore alternatives to it. What I intend to argue is that although there isn't sufficient evidence at this time to justify a complete overhaul of the system, there are nonetheless some adjustments which could be made which would effectively reduce the number of layoffs.

### The Current UI System

The Unemployment Insurance system has historically served two principal functions. It has offered laid-off workers critical income protection during temporary spells of joblessness. And by helping to protect the

incomes of jobless workers, it has thus sustained ordinary spending habits, which has served to give the economy a needed boost during times of recession.<sup>(4)</sup> Hence the objectives of UI are alleviation of hardship, prevention of unemployment, and the promotion of reemployment. The relief of financial hardship for unemployed workers by partial replacement of wage loss is a central aim of the program. And one value of UI, as opposed to simple public relief, is that it enables recipients to maintain their self-respect, as well as it prevents them from sliding into destitution. Another preventive aim of UI is to help minimize the spread and depth of recession through the maintenance of purchasing power. UI can also contribute to the reemployment objective in two ways: 1) It minimizes the disincentive to work -- the preference for leisure -- by placing limits on the weekly amount and the duration of benefits paid. And 2) it minimizes the disincentive to work through job-search and availability-for-work requirements, as well as the way they are administered.<sup>(5)</sup> The duration of benefits should strongly reflect two factors: 1) The prevailing social view about the responsibility for unemployment and reemployment; and 2) The amount of time it takes an individual to acquire and apply relevant labor market information and to find and accept an appropriate job offer. There are two broad categories -- monetary and nonmonetary -- for determining whether or not an unemployed individual is eligible for UI benefits. Monetary eligibility conditions are intended to ensure that those who receive UI had substantial attachment to the labor force prior to their unemployment. Nonmonetary conditions are to ensure that UI recipients are available for and actively seeking work, and also that they are unemployed involuntarily or that they left their jobs for good reasons.<sup>(6)</sup>

Unemployment insurance in both the U.S. and Canada differ somewhat from that in Europe. The typical system in the U.S. and Canada is that workers receive benefits if laid off, but nothing if hours are simply cut back. The typical system in Europe, however, routinely pays short-term compensation (STC) to workers on reduced hours. The discontinuous benefits schedule characterized by the American system would appear to provide incentive for the use of layoffs rather than work sharing during an economic downturn. By contrast, the idea behind STC is that instead of laying off its workforce, it could simply reduce the work week, for example, from five days to four and have its employees draw partial benefits on the fifth day. It is thus believed that STC encourages work sharing, as opposed to layoff.<sup>(7)</sup> And yet, despite similarities between the U.S. and Canada, there are some differences as well. There is a gap between the U.S. and Canadian unemployment rates, and these differences, it is believed, can be attributed primarily to the more liberal UI benefits in Canada. During the 1970s, benefits to unemployed persons other than job losers were significantly liberalized under Canada's Unemployment Insurance Act of 1971. The labor force participation of women also accelerated. In the U.S. benefits are granted primarily to job losers -- workers on temporary and permanent layoff. And under some limited circumstances, workers who quit for "just cause" can qualify. But in general, job leavers, new entrants, and reentrants into the labor force cannot qualify for benefits. The mandate of Canada's law -- to assist "all individuals experiencing temporary earnings interruptions" -- greatly enhanced the availability of UI to unemployed persons other than job losers.<sup>(8)</sup>

This is only one of the limitations of the American UI system relative to others. In a recent study by the Advisory Council on Unemployment Compensation (ACUC), it was agreed that the goals established at the inception of UI are as relevant today as they were in 1935. The program provides an initial line of economic defense for those who become unemployed through no fault of their own, and it spares many of them the indignation of public relief. It also accumulates reserves during periods of prosperity -- reserves which are used during economic downturns to assist unemployed workers in meeting their necessary expenses. And it also serves an important macroeconomic role of helping to stabilize the economy during recessions. But increasingly, jobs are part-time, contingent, or temporary. Since its inception in 1935, the UI system has been based on principles of federalism, with the majority of responsibility for financing and administration being at the state level. The system is "experience rated," which means that employers who have been responsible for imposing greater demands on the system pay higher taxes, and thus bear a greater share of the system's costs. Virtually all wage and salaried workers are covered by UI, with employers paying taxes accordingly. There are, however, exceptions to this. The first exception is that non-profit employers don't pay taxes, despite the fact that their employees are eligible. This exception actually generated an additional cost of \$300 million in 1992. And the second exception is that agricultural workers on small farms aren't covered by UI at all. At a minimum, the ACUC recommends the reversal of these exemptions.<sup>(9)</sup>

Most UI programs provide eligible unemployed workers with a monetary payment to replace some percentage

of their previous wages. Wage replacement is but one objective that is shared by all UI systems. UI programs can also serve as a fiscal stimulus tool that helps stabilize the macroeconomy by injecting additional money into the economy during periods of a downturn. But despite the primacy of wage replacement in the U.S. system, most measures of this function suggest that it is less generous in this country than elsewhere. The percentage of unemployed who receive UI in the U.S. is significantly lower than it is in other countries. The economic stabilization capacity of the U.S. UI system is one of the most limited among nations with similar economies for two principal reasons. 1) Because the wage replacement function is limited, the capacity of the UI system to have a significant macroeconomic effect is also limited. And 2) the increasing reliance on a pay-as-you-go funding structure in the U.S. has also limited its capacity to act as a significant economic stabilizer. Moreover, it isn't clear whether the jobs being accepted by unemployed individuals are the most appropriate jobs in which they take full advantage of an individual's skills, education and experience. One justification for the payment of unemployment benefits is that they allow an individual to focus on searching for a new job.<sup>(10)</sup>

### **Labor Disincentive?**

The UI literature generally supports the notion that UI may in fact create a labor disincentive. Economists have typically viewed unemployment compensation as having a negative effect on the labor market. The argument typically is that high benefits cause the unemployed to be less willing to accept job offers, and also induces those in employment to quit to become unemployed. The rise in unemployment in Western Europe since the 1970s, and its persistence in a number of countries, is attributed in part to more generous levels of benefit payments.<sup>(11)</sup> Feldstein, for instance, has argued that the current system of UI provides substantial incentive for increased temporary layoff unemployment, and that of all unemployment spells, temporary layoffs account for 50%. UI essentially increases the duration of any given spell of unemployment, but it may also induce more very short spells of unemployment. Employers are more willing to lay off workers when they are confident that they will return when recalled. And employees are more willing to be laid off if they can be confident that they will be recalled. The average UI benefit replacement ratio implied by current law can account for about half of temporary layoff unemployment. An increase in the UI benefit replacement ratio from 0.4 to 0.6 raised the temporary layoff unemployment rate by about 0.5 percentage points -- or 1/3 of the average temporary layoff unemployment rate of 1.6% in March of 1971.<sup>(12)</sup>

The literature could be said to consist of a single theme: where benefits are higher, so too are unemployment rates. And where workers expect that there is a chance of being recalled to their former jobs, the likelihood of searching for new employment is diminished. Katz and Meyer, for instance, found that employer recall policies were primary determinants of durations of unemployment spells of individuals with non-negligible recall prospects. Those who expect to be recalled spend less time searching for jobs and have a lower finding rate than other UI recipients. Also the probability of leaving unemployment and finding new jobs increases greatly around the time that UI benefits lapse.<sup>(13)</sup> Contrarily, it is suggested that the reduced availability of UI benefits to job quitters might be expected to reduce the frequency of quitting because it increases the expected costs of leaving employment. If the denial of benefits does in fact reduce quitting, it would only underscore the voluntary aspect of quitters' unemployment and strengthen the argument that such unemployment shouldn't be compensated.<sup>(14)</sup> But do the findings of Katz and Meyer really support the notion that UI creates labor disincentives, or do they merely confirm the assumptions of a model predicated on industrial production? That is, if workers believe that they are to be recalled as opposed to believing that they have been displaced, they are going to behave differently. Displacement differs from temporary layoffs in that those jobs which have been eliminated will never exist again.<sup>(15)</sup> Rather than implying that UI must be decreased -- as much of the literature does -- UI must in fact consist of more than simply income maintenance.

The central premise underlying this literature appears to be that the utility maximizing individual wouldn't work if s/he did not really have to. And to the extent that UI enables the utility maximizing individual not to work because it immunizes him/her from risk, it only furthers that assumption. Workers, it is assumed, exhibit utility-maximizing behavior -- they reveal it through their actions. Income, whether it is derived from labor, transfer payments or other sources, is assumed to give utility. It is also assumed that nonmarket activity -- including leisure -- gives more utility per hour than does work. The income/leisure combination offered by

most UI programs might be preferred by some UI recipients to those offered by a return to comparable employment. Consequently, some recipients may not be diligent in their search for work, or they may adopt criteria for accepting employment which are unreasonably high from society's point of view. This might result in a tendency to remain on the unemployment rolls for longer periods of time.<sup>(16)</sup> And as Meyer has further found, higher UI benefits are found to have a strong negative effect on the probability of leaving unemployment. But the probability of leaving rises dramatically just prior to when benefits lapse.<sup>(17)</sup> On the other hand, those who have been closed out of a job may be in a state of denial. During the early days of their unemployment, they don't really believe that their jobs aren't going to come back, but it finally dawns on them as time lapses.

Still, the literature maintains that workers are at leisure to wait and see because UI offers them something to fall back on. Feldstein and Poterba explain this in terms of workers' reservation wages -- the minimum wages that they will be willing to accept. The principal imperfection in modern labor markets, as they see it, is the downward rigidity of existing nominal wages. Consequently, the decline in marginal value of the product of an employee's labor is likely to cause temporary or permanent layoff, as opposed to a downward wage adjustment. Employees who lose jobs are likely to find that the wages at their next jobs are lower than the wages on the job just lost. Through a comparison of reservation wages with wages of last jobs, Feldstein and Poterba attempt to show the distortions caused by the UI system. The study rests on the assumption that the probability of finding an acceptable job is likely to decline as the reservation wage exceeds the previous wage. The individual's private reservation wage is then said to be at least equal to his/her previous wage. From their sample of unemployed individuals, 24% indicated that they would accept a wage less than 90% of their last wage. An additional 11% were willing to accept between 90-100% of their previous wage. A further 27% indicated that they would accept any wage equal to or greater than the last wage, but nothing less. The cumulative percentage of reservation wage rates was less than or equal to 62%. 38% of the unemployed in the sample had a reservation wage greater than their previous earnings. About 1/4 of those who required a wage increase said they would accept an increase of less than 10%. Fully 28% of unemployed persons said they would only return to work if they received a wage which was 10% higher than their previous wage. The important reason for the high reservation wage ratios and the high fraction of individuals requiring a wage increase as a condition of reemployment is the system of UI benefits. The Department of Labor only classifies one as unemployed if one is available for work and has made efforts to find a job within the past four weeks. But no limit is placed on the individual's reservation wage in defining a willingness to work -- hence unemployment status. Although UI reduces the cost of unemployment to the individual, it can raise the unemployment rate in several quite different ways. For the individual who is unemployed and looking for a job, the lower cost of unemployment implies a higher reservation wage, and hence a longer period of unemployment. And among those who are employed, the low potential cost of unemployment induces temporary layoff in response to reductions in product demand -- even in response to seasonal fluctuations in employees' marginal revenue product.<sup>(18)</sup>

But all this shows is the impact on their behavior. The implication would appear to be clear. Either eliminate UI so that workers will be forced to lower their reservation wages equal to those jobs which are available or tax UI benefits so that whatever incentive there is to remaining unemployed is reduced. Solon, for instance, found that the introduction of taxes on UI benefits for higher-income claimants -- those in families earning more than \$20,000 -- did reduce the mean duration on UI from 10.8 weeks in 1978 to 8.4 weeks in 1979. The large duration reduction among high-income claimants suggests the possibility that the introduction of benefit taxation did indeed affect unemployment duration. And yet, he concedes that the work-incentive effect wouldn't necessarily prove that benefit taxation is a good policy, as it would make UI less effective in its objective of insuring job losers against income reductions.<sup>(19)</sup> But then, why assume that the duration rates were lower because of benefit taxation as opposed to maybe more jobs commensurate with their skills level being available in 1979 over 1978? Is there any real logic to the theory that UI has a negative impact on work incentive? Even if we were to concede the truth of these findings, they do not in any way prove that jobs do exist. Moreover, why would one want to be on UI at only a fraction of one's previous wages?

Burtless, for instance, is insistent that current knowledge of the impact of UI on labor supply is simply too fragile. "Neither theory nor available empirical evidence permits us to predict unequivocally the net effect of unemployment insurance on labor supply." By providing insurance to workers, UI offers something of value

to people who become employed, and it may thus increase the attractiveness of market work. And by supplementing the incomes of workers who become unemployed, it can slow down the process of reemployment. But without better empirical evidence than is currently available, it is impossible to predict which of these two basic effects will predominate. UI may increase the amount of economically productive job search. It might raise the average productivity of workers by improving the match between jobs and workers. In situations where there are say two job vacancies and two unemployed workers, it can be economically productive to subsidize the workers to sort themselves into the two jobs that their joint output and earnings are maximized. This isn't to say that there aren't adverse consequences, rather there is insufficient evidence to make any grand sweeping categorical conclusions.<sup>(20)</sup>

It is on this point that Feldstein and Poterba assume too much. It may be true that UI may increase the reservation wages of those at the lower end of the income scale, but does it really have much of an impact for those at the top? What benefit could there be for a high income individual to sit at leisure at a fraction of previous pay over intensely searching for a replacement of previous wages? UI more closely approximates the previous earnings of those at the lower end of the scale. But as each state imposes a maximum benefit, the higher the previous income was, the less attractive UI becomes. Feldstein and Poterba simply fail to control for demographics, or for that matter the type of employment.

Nevertheless, as Atkins and Micklewright argue, there has been a failure to distinguish several different labor market states. Employment cannot be regarded as homogeneous. A temporary job in the black economy is not the same as a career position with a large enterprise. Work cannot be treated as a homogeneous state either. The unemployed person who returns to work may enter employment or self-employment, and it is the latter which will have different implications, especially with regards to the future entitlement to unemployment compensation. Employment may be full or part-time. There is a distinction to be made between "regular" and "marginal" jobs. Regular jobs are full time and have the expectation of continued employment. They are generally covered by statutory employment protection and are part of the legal economy. They may also offer some prospect for promotion and may involve a substantial element of general or specific training. Marginal jobs, on the other hand, may be temporary or casual; they may be dead-end jobs; they may be part of the black economy; and/or they may be homeworkers. But as they maintain, the treatment of unemployment compensation in the literature has been unsatisfactory for three reasons: 1) In focusing on benefit levels, it has ignored other dimensions of unemployment compensation, whose effects may be more important; 2) It has taken too simplistic a view of the way in which unemployment benefits work in the real world; and 3) The exit from unemployment may have quite different consequences depending on the destination.<sup>(21)</sup>

For the sake of argument, let's say it is true that unemployed workers are more likely to look for work as they approach the point of benefit exhaustion. But is it necessarily true that they waited this long because they desired leisure time? If work is the central activity around which people organize their lives, it stands to reason that the absence of work will be a source of major disruption in their lives. Perhaps the shock of losing a job will effectively immobilize them during the early weeks of unemployment. It may take 26 weeks for them to realize that their layoffs aren't temporary, but permanent. To suggest, as these studies would seem to, that these people would prefer not to work for a period is to ignore the great stigma that many with a continuous work history feel when they are suddenly without work.<sup>(22)</sup> The real issue is the misdesign of the system given current realities, rather than its distortive impact on the behavior of the unemployed. The question, then, is how could it be better designed? The focus on reservation wages also diverts attention from the real issue of whether there is a skills match between those who are laid off and those jobs which are available. To find the appropriate match may take more time, and UI may offer some more breathing space. But this is not quite the same as saying that jobs which exist do not match reservation wages, and therefore they go unfilled. Jobs which do exist may simply not offer an appropriate skills match.

### **Demographics**

To a large extent, the UI system rests on many of the same assumptions of the Schumpeterian model of "creative destruction." According to this model, old and obsolete products and production processes and technologies are continuously destroyed and replaced by the new and technologically advanced. A vibrant capitalist economy, in other words, operates through life cycles, and as products and processes reach the end of

their life cycles, they will be replaced by new ones.<sup>(23)</sup> As far as those workers who are displaced from old industries are concerned, they will eventually be absorbed by the newer ones that come in to take their place. The problem is that there is a lag time. UI, in its current form, did represent a labor adjustment policy for a system in which the new which replaced the old would in essence require the same skills levels among employees. New industries utilizing similar production processes and technologies could rely on the same labor pools. There was, in short, no expectations that workers would shift occupations or that they would need to retrain. But over the years technologies have changed and the result has been an apparent skills mismatch. There is no question that the Schumpeterian model leads to a vibrant capitalism, but at the same time a more effective labor adjustment program may be necessary to bridge the apparent gap. The first question, however, is just who are the unemployed? The second question is just what are the expected trends, i.e the employment outlook for the future?

According to figures from the Bureau of Labor Statistics, the overall unemployment rates ranged from 5.5% in 1990 to 6.8% in 1993, with a peak of 7.4% in 1992. But when the figures are broken down according to occupation and industry, some interesting results emerge.

*Table I Unemployment rates according to occupation and industry*

<b>Occupation</b>	
Managerial and professional specialty	2.6
Technical, sales, and administrative support	5.0
Precision production, craft and repair	6.2
Operators, fabricators, and laborers	8.9
Farming, forestry, and fishing	8.3
<b>Industry</b>	
Nonagricultural private wage and salary workers	6.3
Goods-producing industries	6.9
Mining	5.3
Construction	11.7
Manufacturing	5.5
Durable goods	5.1
Nondurable goods	5.6
Service-producing industries	6.0
Transportation and public utilities	4.8
Wholesale and retail trade	7.3
Finance, insurance, and real estate	3.5
Services	5.8
Government workers	3.4
Agricultural wage and salary workers	11.1

\* these are averages for the thirteen month period from the beginning of January 1994 until the end of January 1995

What stands out among the occupations is that those in production and other types of factory work have higher unemployment rates, and these are precisely the types of people likely to be displaced in today's economy as a function of a permanent plant closure, as opposed to a temporary layoff which would have been characteristic

of yesterday's economy. Or stated differently, those industries requiring lower skills levels from their workers are bound to have higher unemployment rates. What this suggests in terms of developing alternatives to the current UI system is that policies need to be tailored to those workers who are displaced disproportionately from the industrial manufacturing based economy for whom UI was initially designed, as opposed to those displaced from the post-industrial economy. When looking at the distribution of unemployment according to reason over the same time period, we find the following:

*Table II Percent Distribution of unemployed according to reason*

Total unemployed	100.0
Job losers and persons who completed temporary jobs	47.7
On temporary layoff	12.2
Not on temporary layoff	35.5
Job leavers	9.9
Reentrants	34.8
New entrants	7.6

A characteristic which appears to stand out in today's post-industrial economy is that among the job losers, those who are permanently laid off are at least three times those who are only temporarily laid off. This would again suggest that more is needed than simply income maintenance. Rather what is needed is a policy which will facilitate labor market adjustments, as layoffs are more permanent, and so too are job changes. When looking at the distribution of unemployed according to their duration over the same period, we find the following:

*Table III Percent Distribution of unemployed according to duration*

Total unemployed	100.0
Less than 5 weeks	34.6
5 to 14 weeks	30.0
15 weeks and over	35.4
15 to 26 weeks	15.3

There appears to be something magical about the 15th week of unemployment, whereby a higher percentage of unemployed are unemployed during the first fourteen weeks. But after 15 weeks, the percentage of unemployed drops. The question, then, is what is significant about the fifteenth week? And yet, the issue of unemployment spell is quite important given that the mainstream literature holds that the percentages of unemployed workers will diminish as it approaches the point where UI benefits would be terminated. Table III might appear to confirm those findings that suggest that workers may not begin to intensively look for work until they reach the point of benefit exhaustion. As much as 64% of those who are unemployed may be unemployed for up to fifteen weeks. But the number drops to 35.4% after fifteen weeks. Even then we find that close to 80% of those who were unemployed did appear to return to work within 27 weeks. But what we do not know from these figures is of the 80% who are unemployed during the 27 week period, how many are working full time and at equivalent wage rates.

According to the Bureau of Labor Statistics' survey of worker displacement during the early 1990s, about half of those who lost their full time jobs during the period of 1991-93 were reemployed in such jobs by February 1994 and had earnings equal to or greater than those on their lost job. But many others were either employed part-time, unemployed, or simply out of the labor force altogether. Those with the highest rates of displacement were those without substantial experience with their employers. And persons with less than three years of



tenure (the official definition of displacement) made up half of the total 9 million displaced workers, whereas they comprised only about one-third of all workers. The greatest number of displacements occurred in the manufacturing industry, with 1.5 million factory workers being displaced between 1991 and 1993. Although 53% of those reemployed full time reported earning the same or more than their jobs which were lost, those in transportation, public utilities, construction and manufacturing were more likely to find new jobs at substantially lower wage rates. Their new compensation was likely to be 80% or less than their lost jobs. These findings would certainly suggest the need to have some type of retraining program which will work to ensure that replacement wages will be similar. Also according to this survey, 61% of the displaced workers received UI, and of those who received UI, slightly more than 40% exhausted them. On the other hand, the proportion of displaced workers who exhausted their benefits was lower in the early 1990s than it was during the 1980s when the U.S. economy was feeling the effects of back-to-back recessions.<sup>(24)</sup> On the one hand, we may not have a problem in that most people who are laid off find reemployment within twenty seven weeks. But on the other hand, if a considerable proportion of those who do find reemployment are either in different occupations, working at reduced wages or simply as contingent workers, there is a problem in that the system isn't helping them develop marketable skills. The system is merely equipped to provide temporary relief and move people off the UI rolls as quickly as possible. And this simply obscures the real issues.

And what about the 20.1% that are unemployed for more than 27 weeks? Most states only provide UI up to 26 weeks. If it is the case that this cohort has passed the point of benefit exhaustion, what happens to the thesis that UI encourages leisure? The large percentage of this cohort may actually underscore the notion that there is a skills mismatch in the replacement of jobs. This point is only underscored more by the findings in Table IV

*Table IV Percent of unemployed persons according to reason and duration*

Reason, sex, and age	Duration of unemployment					Total	15 to 26 weeks	27 weeks +
	Less than 5 weeks	5 to 14 weeks	15 weeks and over					
Total, 16 years and over	40.8	28.0	31.3	14.1	17.1			
Job losers and persons who completed temporary jobs	43.2	29.2	27.6	13.2	14.4			
On temporary layoff	61.4	29.9	8.7	5.7	3.0			
Not on temporary layoff	33.3	29.8	37.9	17.3	20.6			
Permanent job losers	29.9	27.8	42.3	18.1	24.2			
Persons who completed temporary jobs	41.7	31.4	26.9	15.2	11.7			

Job leavers	40.3	29.0	30.7	14.7	16.0
Reentrants	38.7	25.6	35.7	15.2	20.5
New entrants	31.4	27.8	40.8	15.6	25.3
Men, 20 years and over	38.5	28.6	32.9	13.5	19.4
Job losers and persons who completed temporary jobs	40.6	30.5	28.9	12.4	16.4
On temporary layoff	56.0	34.8	9.3	5.5	3.8
Not on temporary layoff	31.8	28.1	40.1	16.4	23.7
Permanent job losers	29.5	25.8	44.7	17.3	27.4
Persons who completed temporary jobs	37.7	33.9	28.4	14.1	14.3
Job leavers	36.8	30.3	32.9	13.8	19.1
Reentrants	34.8	22.0	43.3	16.1	27.1
New entrants	( <sup>1</sup> )	( <sup>1</sup> )	( <sup>1</sup> )	( <sup>1</sup> )	( <sup>1</sup> )
Women, 20 years and over	41.1	26.8	32.1	14.8	17.3
Job losers and persons who completed temporary jobs	44.5	26.7	28.8	16.0	12.8
On temporary layoff	67.9	23.0	9.1	7.2	1.9
Not on temporary layoff	33.7	28.4	37.9	20.0	17.9
Permanent job losers	29.0	29.8	41.2	20.2	20.9
Persons who completed temporary jobs	45.9	24.7	29.5	19.4	10.1
Job leavers	40.2	30.5	29.4	14.8	14.5
Reentrants	37.9	26.5	35.6	13.8	21.8
New entrants	33.8	23.9	42.3	10.9	31.4

Both sexes, 16 to 19 years	47.7	28.6	23.7	14.3	9.4
Job losers and persons who completed temporary jobs	63.0	29.3	7.6	6.2	1.4
On temporary layoff	82.0	15.2	2.7	2.2	.5
Not on temporary layoff	47.4	40.9	11.7	9.5	2.2
Permanent job losers	42.5	41.1	16.4	12.4	3.9
Persons who completed temporary jobs	( )	( )	( )	( )	( )
Job leavers	( )	( )	( )	( )	( )
Reentrants	46.1	29.5	24.4	16.5	7.9
New entrants	34.9	29.0	36.1	16.2	19.9

\* these figures are only for the month of  
January 1995

What is consistent throughout is that most of those on temporary layoff are only unemployed for less than five weeks, whereas those on permanent layoff -- those who may be displaced -- are more likely to be unemployed for fifteen weeks or more. When looking at unemployment according to mean duration of unemployment during the month of January 1995, we find the following:

*Table V Mean duration of unemployment according to sex, race and marital status*

	<b>Average (mean) duration</b>	<b>Median duration</b>
<b>Total</b>		
Total, 16 years and over	16.5	7.7
16 to 19 years	11.5	5.3
20 to 24 years	11.9	4.8
25 to 34 years	16.0	7.8
35 to 44 years	18.9	9.0
45 to 54 years	22.0	10.4
55 to 64 years	22.3	9.4
65 years and over	20.8	7.8
Men, 16 years and over	16.9	7.9
16 to 19 years	11.4	6.2
20 to 24 years	11.9	4.9

25 to 34 years	16.9	8.1
35 to 44 years	18.5	8.4
45 to 54 years	23.1	10.5
55 to 64 years	25.0	12.1
65 years and over	25.0	9.5
Women, 16 years and over	15.9	7.5
16 to 19 years	11.8	4.2
20 to 24 years	11.8	4.5
25 to 34 years	14.9	7.4
35 to 44 years	19.6	9.9
45 to 54 years	20.8	10.2
55 to 64 years	19.0	7.9
65 years and over	( <sup>1</sup> )	( <sup>1</sup> )
<b>Race</b>		
White, 16 years and over	15.4	7.2
Men	16.2	7.5
Women	14.2	6.7
Black, 16 years and over	20.2	9.7
Men	19.4	9.3
Women	20.9	10.2
<b>Marital status</b>		
Men, 16 years and over:		
Married, spouse present	17.2	8.3
Widowed, divorced or separated	18.5	8.3
Single (never married)	16.2	7.2
Women, 16 years and over:		
Married, spouse present	15.1	7.5
Widowed, divorced, or separated	19.1	9.2
Single (never married)	14.7	6.2

This merely shows that the mean duration increases along with age. And yet, the variation really isn't that great. Nevertheless, there may be two ways to look at this: Either there is no problem because the duration on unemployment isn't too long, or because those between the ages of 35-64 will have longer periods of duration we need to raise questions as to where efforts to offer retraining or some other alteration of the system should be targeted. Older workers are more likely to have been with their employers for longer periods of time, and therefore to be more in need of skills upgrading. But when we look at the duration of unemployment according to occupation and industry, we find a little more variation:

*Table VI Mean duration of unemployment according to occupation and industry*

	<b>Average (mean) duration</b>	<b>Median duration</b>
<b>Occupation</b>		
Managerial and professional specialty	19.9	9.3
Technical, sales, and administrative support	15.9	6.9
Service occupations	16.5	7.8
Precision production, craft and repair	15.3	7.8
Operators, fabricators, and laborers	15.3	6.9
Farming, forestry, and fishing	15.9	8.6
<b>Industry</b>		
Agriculture	14.1	7.5
Construction	13.4	6.2
Manufacturing	17.8	8.7
Durable goods	18.2	8.5
Nondurable goods	17.5	8.8
Transportation	17.8	8.5
Wholesale and retail trade	15.5	6.9
Finance, insurance, and real estate	15.7	8.9
Services	16.2	7.6
Public administration	25.5	10.4
No previous work experience	19.5	10.1

The next question, of course, is just what the employment trends for the future are. According to the Bureau of Labor Statistics, the U.S. labor force is expected to increase over the 1992-2005 period by 24 million, from 127 million to 151 million. 51.2 million are expected to enter the labor force, with 27.7 million representing the replacement for those workers who leave due to death, retirement and other reasons. Virtually all job growth is expected to be in the service-producing industries. Approximately one third of all jobs created are expected to be in health, business and social services. The fastest growing jobs will be in professional specialties, managerial and technical occupations -- those that would require the most education. And yet, the fastest growing major occupational group requiring little education will be the service worker. The seven fastest growing occupations are health and computer related -- positions requiring higher skills levels.<sup>(25)</sup> These projections would only tend to reinforce the current trends in what has come to be known as the two tiered economy. Those working in low skills service occupations will find themselves in the low wage labor market, while those working in high skills occupations will find themselves in the high-wage labor market. The implications would appear to be rather clear: If what has traditionally been regarded as the middle class is to be maintained, there will need to be an array of training programs in place which can facilitate the labor market adjustment from the industrial sector based economy to the post-industrial sector based one. The question remaining is whether the UI system should be the focus of such efforts.

### **Alternatives?**

Under federal law, UI claimants may participate in state-approved training without a loss of benefits. But current law does not allow for the use of state unemployment funds for anything other than payment of benefits, certain refunds, and payment of medical insurance premiums in a state-approved plan at claimant's option. A state may not withdraw money from its unemployment trust fund to pay the costs of job search, training, or starting a new business. And yet, once benefits have been paid, there are no restrictions on how a claimant chooses to spend it, which could then include job search, training, and relocation. Current law, in short, doesn't offer much room for other alternatives to the traditional UI system. But there are a number of alternatives which should be considered before looking at the issue of training. These alternatives include: self-employment, individual development accounts, employment bonuses, more perfect experience rating, and work sharing.

*Self-Employment* . One option would be to allow for UI recipients to either collect their UI in one lump sum which could be applied towards the start of a business, or to allow them to draw regular UI benefits while they are trying to start one. Some European countries already have this option; the U.S. does not. Canada has actually experimented with self-employment programs as an alternative to re-employment options. The first experiment was the Self-Employment Initiative (SEI) which was introduced in 1987 as part of the Community Future program under the Canadian Job Strategy. SEI was later replaced by the Canadian Self-Employment Assistance (SEA) program in 1992. This move had the effect of creating a self-employment program within the mandate of UI Developmental Use. A study by the Canadian government's Insurance Programs Directorate found that SEI participants were on average successful in reducing their reliance on UI. On average, 1988-89 cohorts of SEI clients had 1.2 fewer claims after SEI compared to the average of the three years before SEI participation. The SEI program overall also had a positive impact on total earnings of the participants. The total annual earnings of each participant increased, on average, by \$3,911 relative to the comparable group of non-participants. Increases did vary regionally, with the highest gains being found in Newfoundland with an average of \$9,853 per participant, and the lowest being found in Quebec with \$5,521 per participant.

The initial SEI program made income support available at a flat rate to eligible candidates for a maximum of 52 weeks while they established a business. The SEA option, in addition to income support, incorporated training as a central part of client support. The principal differences between the SEI and SEA were: 1) Geographical restrictions were relaxed under the SEA. Eligibility can now be established by UI clients living in selective labor market areas that aren't *Community Futures* programs; 2) Training is made available to SEA participants in order to increase their chances of success in self-employment, whereas it had been left to participants under SEI to find it on their own; 3) Designated groups are treated as priority clients with respect to acceptance into the SEA program; with SEI they weren't; 4) Prior to being accepted into the SEI program each applicant was required to submit a business plan. Under SEA, the requirement was dropped in favor of an orientation session -- to determine the suitability of each applicant for self-employment; and 5) A flat rate of \$230 was paid to SEI participants. Under SEA, the average weekly UI benefit rate in 1992-93 was \$327 including \$8 for a supplementary allowance.

An analysis of the SEI program demonstrates that SEI participants were successful in reducing their reliance on UI. SEI clients, on average, had 1.2 fewer claims. They received 35.6 fewer paid weeks of UI benefits, and \$6,430 less in UI benefits in the three years following SEI than in an equivalent period prior to SEI participation. Job tenure for participants immediately prior to SEI enrolment was brief. Approximately 71.7% of UI participants worked one year or less in their jobs immediately prior to SEI enrolment. Moreover, the two year overall survival rate was 88.7% and 83.6% between 1988-89 and 1989-90 respectively. The three year overall survival rate was 76.2% between 1988-90.<sup>(26)</sup> The U.S. Labor department did conduct a review of the unemployment insurance system and its alternatives and concluded that the available evidence on the effectiveness of alternative uses of UI funds was not an adequate basis for major changes in a program which has been successful in meeting its objectives since the 1930s.<sup>(27)</sup> And yet the prospect of starting a business ought to offer any number of workers a tantalizing possibility. But then, this would assume that UI benefits alone could be the source of sufficient start-up capital.

*Individual Development Accounts?* Michael Sherraden has suggested that the American welfare state could be reformed if the poor could be offered the opportunity to accumulate assets, which they would then be able to draw upon in the future as the need might arise. The core of this strategy would be the Individual Development

Account (IDA).<sup>(28)</sup> As a variation on this, we might consider depositing UI benefits into such IDAs which could then be used for the purpose of retraining. In this vein, the UI system could be made to do more than simply offer income maintenance. It could assist in the transition. Still, this doesn't address the need that many will still have for income maintenance during the period that they seek retraining or they are attempting to start their own businesses.

Perhaps the system could be completely overhauled and we adopt Sherraden's solution to the challenge raised by the current economic realities for the existing UI system. What if instead of offering UI when people are laid off, we offered them credits to be deposited during the course of their working lives? Now somebody who is suddenly displaced after twenty years of factory work for instance would have enough assets to live off of as well as retrain. And for the one who isn't laid off, that account could further be drawn upon for the purposes of changing careers or financing the education of one's children. Such a plan would encourage savings and perhaps lead to greater independence.<sup>(29)</sup> Similarly, Robert Haveman has suggested that in lines with overhauling the entire tax and transfer/redistribution system, we think of creating a Universal Personal Capital Account for youths, whereby each youth upon reaching the age of 18, would receive a personal capital account of say \$20,000 from the government. The account would be interest earning and could be drawn upon for approved purchases of education and training, as well as health care services. The idea here is to empower individuals to make choices -- to generate more equal opportunities -- but at the same time maintain the concept of personal responsibility. Individuals would be responsible for the choices they made, but they would also have the incentives they need to train and/or retrain as necessary.<sup>(30)</sup> Although Haveman isn't necessarily proposing this as a replacement for UI, a variation on this idea might certainly be worth looking at. Certainly it would make for a more versatile welfare state.

Another version of this would be to impose an experience-rating tax on workers. Workers would have individualized accounts similar to the individualized UI accounts employers currently have. Workers would pay into their accounts while employed, and draw from it when unemployed. Those with low account balances upon returning to work would be required to pay a higher tax rate on earnings. But it would also be possible to provide a "cash-in" option, whereby the account balance could be turned over to workers on retirement. If such a system were to be "perfectly" experience rated, it would impose extremely high tax rates on those individuals who experience the most unemployment.<sup>(31)</sup>

*Employment Bonuses?* Another option to consider along the lines of building greater incentives into the system would be to offer employment bonuses. This would consist of a payment which would be made to an unemployed individual when s/he accepted a job offer and met other qualifying conditions. The purpose is to encourage more rapid reemployment, thereby lowering the overall unemployment rate. It has been suggested that a reemployment bonus program could reduce the duration of insured unemployment without the adverse consequences for workers who are offered a bonus. The Illinois Department of Employment Security conducted two controlled experiments between mid-1984-1985 designed to test the effectiveness of cash bonuses in reducing the duration of insured unemployment. In one experiment, known as the *Claimant Experiment*, a random sample of new claimants for UI were instructed that they would qualify for cash bonuses of \$500 if they found a job of thirty hours or more per week within 11 weeks of filing UI claims and if they held their jobs for more than four months. The intent was to create an incentive for claimants to search more intensely for work. In the other experiment, known as the *Employer Experiment*, a second random sample of new UI claimants were told that their next employer would qualify for cash bonuses of \$500 if they -- the claimants -- found a job within eleven weeks of filing UI claims and if they retained their jobs for four months. Here the intent was to provide a marginal wage-bill subsidy -- a training subsidy -- that might reduce the duration of insured unemployment. The four month employment requirement was intended to avoid the possibility of fraudulent hire -- solely for the purpose of obtaining the bonus. Each claimant was assigned to one of three groups: 1) control group; 2) claimant experiment treatment group; or 3) employer experiment treatment group. The incentives facing the UI claimants assigned to the claimant experiment may be viewed within the context of either a job search model or an income-leisure model of labor supply. Within the search context, a \$500 bonus creates incentive for unemployed workers to either lower their reservation wage or search more intensely. Within the labor supply context, a \$500 bonus raises the opportunity cost of leisure consumed during the period of time immediately following the initial claim. It creates an incentive to substitute income for leisure. The results strongly suggest that the claimant Experiment reduced the duration of job

search for those who participated in it. Also, the relatively rapid reemployment of Claimant Experiment participants did not come at the expense of lower earnings. The data is thus consistent with the idea that faster reemployment resulted from more intense job search efforts, and not from a rapid acceptance of job offers.

According to Woodbury and Spiegelman, the results of the Claimant Experiment are unequivocal and strong. The incentives created by the bonus -- paid out to 4,186 UI claimants -- reduced the state's regular benefits paid to the randomly selected treatment group by an average of \$158. And it reduced the average number of weeks of insured unemployment by more than one week -- over the full benefit year -- compared with the randomly selected control group. Also some results of the Employer Experiment were also unequivocal and strong. White women who were randomly assigned to the Employer Experiment received \$164 less in UI and experienced one week less of insured unemployment than did white women assigned to the control group.<sup>(32)</sup> Nevertheless, there was the question regarding the displacement effect, if any. Because the bonus program makes it easier to fill vacancies, it might affect the job separation rate. The bonus program could make firms more prone to terminate workers for cause and less prone to create conditions that would lower the probability of voluntary quitting. Termination and voluntary quits create vacancies that are costly to fill, and because the bonuses reduce these costs, they should rise as a result. Davidson and Woodbury estimated that the bonus program wouldn't have a displacement effect on UI-eligible nonoffered workers, although in all cases there is some displacement of UI-ineligible. Still, the Illinois bonus program had virtually no effect on the earnings of those workers who were offered a bonus after reemployment.<sup>(33)</sup> Although the ACUC notes this as a possible approach to modifying the UI system, it does caution that the effects are marginal at best. Paying recipients to find jobs more quickly will have little effect if there are no jobs to be found.<sup>(34)</sup>

At the same time, however, the data on these experiments, as is the case with other UI reforms, is inconclusive. In a more comprehensive review of these experiments, Meyer has suggested that cost-benefit analyses indicate that bonus experiments usually lead to small net losses for the UI program, and are about break-even for society as a whole. If, for instance, claimants are induced to find a job more quickly, the job they find may be less desirable. Experiments, however, show that there are no statistically significant declines in earnings. Many of the bonuses offered to workers actually indicate no change in earnings, or a small increase. Still, it is unclear as to whether experimental results can be directly applied to a permanent program. And there are three sources to this uncertainty. The first is that if one group of individuals is encouraged to go back to work early, they may gain employment at the expense of others who are unable to get jobs. Secondly, with a permanent program, a different fraction of eligible claimants might apply for bonuses, thereby causing a change in the costs of the bonus offer. And thirdly, by increasing the financial reward for short UI spells, a permanent bonus would probably increase the number of people unemployed between job changes and increase the number of UI filers. Although bonuses experiments do show that economic incentives do affect the speed with which people leave the UI rolls, they do not necessarily demonstrate the desirability of a permanent reemployment bonus program. On the contrary, simple cost/benefit analyses suggest that societal net benefits may be positive about one half of the time, but they are negative in other cases. And they actually generate small losses for the system. Rather, reemployment bonuses make filing for UI much more valuable, as claimants become more eligible for a large payment if they file and then find a job soon. The permanent adoption of a reemployment bonus could actually have important unintended negative effects, for the key drawback of the experiments is that they cannot account for the effect of a reemployment bonus on the size of the claimant population.<sup>(35)</sup>

*More Perfect Experience Rating* . Another way to approach the issue of reform is ask how employer layoffs might be reduced, as opposed to how workers might be better motivated to look for new jobs once they are laid off. Such an approach might involve alterations in the UI financing system which would make it more costly for employers to lay their workers off. In all other countries, UI benefits are financed by flat-rate payroll taxes, or out of general tax revenues. There is no connection between an individual firm's behavior and its tax liability. In the U.S. UI is financed through an experience rated payroll tax. Firms more likely to lay off their workers are bound to pay higher taxes. And yet, as Robert Topel points out, the concept of experience rating of UI taxes has very little relation to the idea of experience-rated premiums in the insurance literature. Rather an imperfect experience rating of UI taxes is likely to encourage unemployment. Layoffs generate income for a firm's workers that has no corresponding cost for employers, thereby creating an incentive to compensate workers with UI rather than earnings. Unemployment thus becomes relatively more attractive. It implies that both the incidence and duration of temporary layoff spells is increased.



The easiest type of reform might simply be to have a more perfect experience rating by extending the range of tax rates. According to Topel, a reduction in the minimum tax rate to zero and a dramatic increase in the maximum rates would have two effects: 1) Unemployment subsidies would be sharply reduced. This might result in the industrial mix of employment and production not being so severely distorted. And 2) the primary source of wedge in layoff and rehire decisions would also be eliminated. This might have a strong impact on unemployment in general, especially temporary layoffs. [\(36\)](#)

*Work Sharing* . Work sharing involves the payment of UI benefits to employees as partial compensation for the loss of hours worked. So instead of laying workers off, firms simply reduce their hours. This is the idea of Short-term Compensation (STC). The Canadian government, for instance, has also been experimenting with work sharing under its Skilled Investment Program of Canadian Jobs Strategy. Work sharing is considered "counter-cyclical," as program use intensifies during periods of economic decline and subsides when the economy improves. The principal objective of the program is to maintain employment levels during periods of economic decline. Work sharing essentially seeks to avert layoffs by redistributing unemployment within a firm rather than laying off workers. Work sharing consists of both primary and secondary objectives. The primary objectives are to maintain local, regional and industrial employment levels during periods of short-term adverse economic conditions, and to cushion the effects of permanent labor force reductions. The secondary objectives are divided into two categories: firm and employee. For the firm they are to assist firms to maintain their skill labor forces intact, and to avoid the costs to employees and the economy associated with temporary layoff -- particularly the costs of recruiting and training new employees to replace those who wouldn't return after the layoff period. And for the employee, the objectives are to assist them in maintaining their skill levels and work motivation, and to reduce the dislocation and uncertainty as a result of the layoff. Another objective is to permit a broader sharing of the burden of reduced employment activity and better income maintenance for those who would otherwise be laid off.

The basic concept underlying Work Sharing is to spread an overall reduction in working hours across all workers in a designated unit instead of a more traditional alternative of temporarily laying off a smaller number of workers. The lost wages are partially compensated by UI benefits -- approximately 60% of lost wages are covered by UI benefits. On the other hand, one of the more theoretical disadvantages is that of inappropriate adjustments. That is, some workers and firms may avoid more appropriate adjustment strategies because Work Sharing encourages them to avoid these more drastic, but perhaps arguably more appropriate strategies. Still, beginning with UI costs, Work Sharing is more expensive than the layoff alternative. The Insurance Programs Directorate of Canada figured that there was a 33% cost disadvantage vis a vis layoffs using administrative data on all Work sharing UI payments. Approximately \$208 of UI payments were received by participants during and after the program. Overall, those individuals who were most likely to have experienced layoff within a Work Sharing unit did much better than their counterparts in the layoff comparison groups. But it was also clear that Work Sharers who weren't going to be laid off did somewhat worse under the Work Sharing program since they would have no reductions in earnings. In terms of skills retention, Work Sharing participants are probably more likely to retain their original skills than the layoff group. The overall conclusion of the study, then, is that there is an advantage after the agreement in terms of a quicker return to production for participating Work Sharing firms. Work Sharing firms were found to be less likely to have experienced layoff in their past employment history than employees in comparison groups. Although it is a good program, it has nonetheless failed to respond to some of the key changes in its operational environment. [\(37\)](#)

Nevertheless, there are those who believe that the addition of Work Sharing or STC is the key to strengthening and sustaining the UI system during the next half century. Morand, while he acknowledges the studies indicating that it can be more costly than traditional UI, argues that STC can be cheaper to administer for workers, employers, and the system. It requires no job search to be policed or subverted. It keeps people out of Employment Services' hair. It doesn't lead to denials and appeals. And it is the only labor market legislation which enjoys support from corporations and unions, as well as conservatives and liberals. Because UI is publicly perceived as legislation for losers, it may contribute to a more positive image, as well as enlarge the constituency of supporters to the extent that it encourages and subsidizes job preservation. Most workers aren't fired, but laid off. STC thus encourages a rightful expectation that everyone willing to work will continue to do so. [\(38\)](#)

Other alternatives might include reforming UI so that it is better integrated with training programs. The government of Canada, for instance, has issued a report exploring some alternatives to the current system of temporary subsistence payments. One approach is to design a new Employment Insurance Program, which would more closely integrate UI with other employment development services. This approach essentially recognizes that for some employment problems are deep-seated, and that income support isn't enough to help them get back to work. Therefore, a distinction would be made between frequent claimants and occasional claimants. Occasional claimants would receive Basic Insurance which would be no different from the current system. Frequent claimants, however, would receive Adjustment Insurance which could be paid at a lower rate than Basic Insurance. The remainder of their benefits would be in the form of in-kind retraining and or counseling services. Depending on their labor market needs and the resources available, both frequent and occasional claimants could have access to individualized packages of employment development services designed to enhance their prospects for employment. At the same time, the report makes it clear that a new Employment Insurance program would also need to take account of regional differences in the Canadian workforce. The report also suggests that as a means of targeting resources where need is the greatest, adjustment insurance benefits could also be income-tested, based on an assessment of claimants' individual or family income.

The second approach would merely involve adjusting the existing UI program. It would retain the shape of the current program and involve either increasing the number of weeks of work required to qualify for UI, or reducing the amount of benefits available by shortening the duration and/or lowering the level of benefits. This would supposedly free money up from the UI program which could then be channeled into other labor market adjustment activities.<sup>(39)</sup> The problem with either of these approaches is that the need to create a system which will better work to insure employment by no means obviates the need of those who are laid off or displaced for income maintenance during the period in which they are engaged in retraining. At some basic level, an income maintenance program is still necessary. The question which needs to be addressed is why an overhaul of the current system, as opposed to simply offering retraining on top of UI. In other words, would it be possible to better integrate current programs with the UI system?

### **What are the Current Programs?**

If there is a need for an overhaul of the system, it is because of the problem of displaced workers. And indeed, the response of the U.S. federal government has been modest. It has essentially relied on the current UI system in conjunction with amendments to Title III of the Job Training Partnership Act (JTPA). JTPA was passed in 1982 to replace the discredited Comprehensive Employment and Training Act (CETA), as well as reorganize the nation's remedial employment and training programs for the economically disadvantaged. The range of services provided by CETA had included classroom training, on-the-job training in the private sector, public service employment (PSE), and work experience. A small number also received job placement services. As unemployment rose during the 1970s, CETA expenditures shifted away from training programs towards the provision of PSE job slots. But the successor programs of JTPA and the Economic Dislocation and Worker Adjustment Assistance Act (EDWAA) have moved away from PSE towards job search assistance services (JSA).<sup>(40)</sup> But CETA was discontinued on the grounds that in addition to fraud and corruption, it hindered movement into the private labor force by shielding workers from the market. And in fact, the modest size reflected deep skepticism about the efficacy of government action.<sup>(41)</sup> The JTPA did provide job training and job search services for both disadvantaged and dislocated workers, but it eliminated public service employment and cash stipends for workers receiving training. It also attempted to obtain greater private employer involvement through the creation of employer dominated Private Industry Councils. As of 1988, JTPA was providing about \$200 million annually at the state and local levels for the retraining of workers permanently displaced from their jobs. In program year 1993, there were 226,000 total EDWAA participants at a cost of \$352 million. The Funds are generally used to provide classroom training, on-the-job training, and job search assistance to program participants.<sup>(42)</sup> The UI system, to which this program was merely appended, was initially designed to prevent workers from seeking career changes or upgrading their skills. But JTPA wasn't enough.

The first problem was that it lacked comprehensiveness. One effectively could not engage in retraining if the result was to be the loss of needed UI benefits. The other problem was that workers and communities simply lacked sufficient time to prepare and plan programs for the displaced because firms closing their doors weren't providing adequate notice. This problem was in part rectified with the passage of the Worker Adjustment Retraining Notification Act (WARN) in 1988. WARN mandated sixty days advance notice of plant closure to those working in firms with more than 100 workers. But WARN lacks any real teeth. It has never been assigned to an agency for enforcement. Rather, enforcement is through the courts. Nevertheless, an argument for WARN is that one of the most important benefits of advance notice is that it gives companies, workers and their unions, and government agencies time to plan and develop adjustment assistance.<sup>(43)</sup>

WARN, to a large extent, was meant to be a complement to EDWAA, also passed in 1988. EDWAA established a dislocated worker unit in each state which would be responsible for providing job counseling and other services to the displaced. EDWAA provided authorized funding of \$980 million during the fiscal year beginning July 1989. The idea was to compensate for the deficiencies of JTPA and to in effect supplement the existing UI program. And as Gary Hansen argues, by creating a national dislocated worker adjustment program, the U.S. is one step closer to having a comprehensive and coherent national employment and training policy.<sup>(44)</sup> But at the same time, the programs are disjointed. The Labor Department has also noted that for a substantial proportion of workers displaced by plant closure or large-scale layoffs, basic readjustment services are not sufficient to enable individuals to locate stable reemployment. Many dislocated workers need basic educational skills and literacy training in addition to occupational training. What EDWAA does is emphasize the importance of offering retraining when needed to prepare dislocated workers for jobs with long-term potential.<sup>(45)</sup> The question in need of addressing is whether a comprehensive employment and training program can be arrived at simply by tinkering at the margins with the existing programs, or whether it would be better to have one single program. And if we opt for a single program, should it be separate from or part of the existing UI program. And yet, it isn't at all clear that a discussion of overhauling the current UI program so that it would effectively become what the Canadian government refers to as an employment insurance program can really be divorced from more general discussions of overhauling the American welfare state in its entirety.

A principal question, of course, is whether government training programs are really effective. Leigh has found that based on demonstration projects in four states, JSA services have an intended effect on a variety of labor market outcomes which include earnings, placement and employment rates, and the amount of the UI benefits. The evidence gathered for all four demonstrations indicates that classroom training fails to have a sizeable incremental effect on earnings, employment, and UI benefits above that of JSA only. It doesn't appear to be the case that the additional effect of classroom training is large enough to compensate for the higher costs of those services. Moreover, given that the objective of the Demonstrations was to encourage rapid reemployment through the UI system, it isn't surprising that program services primarily assisted those workers with marketable skills.<sup>(46)</sup>

But we may also draw a lesson from the Canadian experience. As part of its UI Developmental Uses program, Canada experimented with training programs, and found that they did have some beneficial results. To study the effects of training, the Insurance Program Directorate looked at six categories of workers: Feepayers, Job Development, Job Entry, Skill Shortages, DIR, and non-trainees. Feepayers were comprised of individuals who were paying for training on their own in approved courses restricted to designated skills shortages and language training. To qualify, recipients had to have been out of school for more than two years and their courses had to meet at least 25 weeks, but they couldn't exceed 52 weeks. Though they were to pay for the courses themselves, they would be able to draw UI while enrolled. In the Job Development program, clients must have suffered long-term unemployment which was defined as being unemployed for at least 24 weeks during the previous 30. The Job Entry program was for either women reentering the workforce after an absence of at least three years (job re-entry) or youth who were no longer required to attend school and who had little labor market experience. Such youth were defined as those who had been out of school for a minimum of three years and who had been unemployed for at least 26 out of 52 weeks (job entry). Priority, however, was to be given to high school drop-outs. Full-time courses couldn't last longer than 52 weeks, and part-time courses couldn't last longer than 1,820 hours. The Skills Shortages program applied to those who were "not job ready" and who didn't meet the criteria for other programs could be eligible if counselors felt that

they could benefit from training. Training could last up to three years, but only those clients with a minimum of five years in the labor force could train for longer than a year. In the DIR program, clients either took training -- often in the evening -- which didn't interfere with their job search, or didn't inform authorities that they were involved in training while on UI. The results of these programs can be seen in the following table:

	Pre-UI earnings	Post-UI earnings	Placement rate	Pre-average annual earnings	Post-average annual earnings
Feepayer	\$425	\$448	67%	\$16,375	\$18,719
DIR	\$427	\$420	61%	\$13,877	\$15,299
Job Development	\$361	\$383	58%	\$12,833	\$13,958
Job Entry	\$268	\$324	61%	\$8,016	\$12,113
Skills Shortages	\$377	\$480	75%	\$18,775	\$24,245
UI-Only/non-trainee	\$477	\$428	---	\$18,082	\$19,981

In the Feepayer program, the typical respondent was 32 years old with 13 years of education. They earned \$425 weekly in their last job prior to UI and \$448 in their job after. Training courses lasted 34 weeks and 2/3 obtained jobs in the field they trained for. In the two years prior to UI, the average annual earnings were \$16,375, with the annual earnings being \$2,344 more in the second year after UI. In DIR, clients on average were 31 years old with 12 years of education. They earned \$427 per week in their last job prior to UI and \$420 in the first job following. Training courses lasted 19 weeks and 61% got jobs in the fields they were training for. Average annual earnings two years prior to UI were \$13,877, with earnings of \$1,422 more in the second year following UI. In the Job Development program, trainees were among the oldest with an average age of 33, and with twelve years of education. Trainees were also mostly women. They earned \$361 in their last jobs before UI and \$383 in their jobs after UI. Development training lasted 31 weeks and 58% got in-trade placement. Earnings averaged \$12,833 in the second year before UI and \$1,125 more in second year following UI. In the Job Entry program, the typical respondent was 31 years old with twelve years of education. The ratio of women to men was 7:3, and it was in this group that the lowest earnings were reported. They earned \$268 before and \$324 after. Training would last 27 weeks and 61% were able to obtain jobs in the fields for which they were training. Average earnings two years prior to UI were \$8,016 and \$4,097 more in the second year afterwards. In the Skill Shortages program, were among the youngest, with an average age of 28, and with twelve years of education. Trainees were overwhelmingly male -- 88% -- and nearly 3/4 were apprentices. They earned \$377 before UI and \$480 after. Training courses lasted 19 weeks and 75% obtained jobs they trained for. Average earnings two years prior to UI were \$18,775 and \$5,470 in the second year after. This group actually showed the greatest gain. And lastly, the Non-trainees were the oldest of all the groups with an average age of 35. They were also among the least educated, with ten years on average. They earned \$477 before UI and \$428 after. But despite this initial loss of earning power, they were still ahead in their second year following UI. Average earnings two years prior to UI were \$18,082 and \$1,899 more in the second year following UI.

Overall, the study found that participants in the Feepayer and Skills Shortages programs were no more likely to become reemployed than UI-only groups. DIR, Job Development and Job Entry trainees were generally less likely than UI-only claimants to obtain a job after UI and/or training. Trainees, however, did require substantially less time -- 11-17 weeks depending on the training program -- than non-trainees to find a job following UI/training. Still, a modest but significant rise in the incidence of welfare receipt was observed for Job Entry and Job Development clients.<sup>(47)</sup>

There are those who caution against the use of UI for retraining programs. Lee Hansen and James Byers, for instance, argue that while proposals to join together traditional unemployment compensation with retraining might have a certain appeal, they may actually threaten the integrity and viability of the long-established unemployment compensation system by joining together two quite different functions which will be difficult to link effectively and will add considerable cost to the UI system. In particular, they emphasize the uniqueness of

the American system. Three elements distinguish the American system from European ones. The first is that the American system is narrowly focused and represents a radical departure from relief or welfare programs. Second, the U.S. system has been completely wage-related, rather than needs-related, as is the case in Europe. The third and perhaps most important element is that the American system was designed to be insurance. It is this third point which they believe would be seriously undermined if training programs were to be joined to traditional UI. And to use their analogy, to assume that UI should support a worker in retraining is analogous to expecting that an auto insurance company will pay for one's children's driving lessons.<sup>(48)</sup>

Perhaps the real issue is why has employment policy been abandoned. As Weir has noted, for a nation claiming the work ethic as a central feature of its political identity, the U.S. has been lax in introducing and sustaining policies which actively promote employment. There would appear to be a paradox in American social and economic policy. In part, the answer may lie in the fact that employment policies became entangled with two concerns in American politics: 1) the economic and political position of minorities and 2) the role of the federal government. As Weir sees it, the defeat of the Full Employment bill in 1945 signaled the political failure of "social Keynesianism" which joined economic and social policies by institutionalizing government spending to ensure full employment. During the 1950s, a structuralist view of labor markets had emerged. Few empirically oriented economists in the Labor Department began to support a range of policies including skill training, job placement, measures to aid mobility, and public employment. This line of thinking did have an influence on the War on Poverty programs which had incorporated two decisions about the proper focus of labor market policies. First, there should be remedial measures targeted on the lowest end of the labor market. And second, policy should aim to alter the supply of labor by mobilizing workers' characteristics, as opposed to seeking to change the demand for labor.

It doesn't follow, however, that just because employment policies in the past may have had little success, employment policies in the future will similarly meet with little success. Rather many were hindered because of the political context in which they were forged. The political fate of the War on Poverty was deeply affected by its identification with the upheaval in racial politics during the 1960s. Following the War on Poverty, efforts to link poverty to employment problems simply faced new barriers. Policy was essentially carved up into two realms: the politics of economic policy and the politics of poverty. But neither one of them were united by a broader politics of employment. And with the breakdown of the near-consensus on Keynesian ideas which had characterized the economics discipline for almost two decades, the views of Milton Friedman and Martin Feldstein regarding natural rates of unemployment became increasingly more popular among academic economists.<sup>(49)</sup>

### **Implications for Policy**

As diverse as the literature is on unemployment insurance, there would appear to be a single theme which stands out: The current UI system does require change. But it is on the issue of what type of change that there is a wide spectrum of thought. There would appear to be two major directions for change. One is to maintain the basic integrity of the system and make some adjustments intended to affect both individual and firm behavior. The other is to overhaul the system completely -- to transform it into a system offering temporary relief during periods of economic distress into a system which facilitates labor market transitions in conjunction with economic transformations. But these two different directions stem from fundamentally opposing premises. The first direction merely assumes that the system is so designed that in either encourages firms to make more use of layoffs or workers to opt for greater leisure as opposed to more intensive job search. It does not necessarily assume that there is a mismatch between the jobs which are available and the skills which workers are able to sell to prospective employers. The other approach, however, does. It assumes that the economy has changed, and that a system designed to assist workers during spells of temporary layoff is not equipped to truly assist those workers who will never be called back because their skills are now obsolete. The system must attempt to find ways by which workers can be prepared for new economic circumstances. These directions rest on fundamentally different assumptions, and what isn't clear is which school is correct. What would appear to be clear is that the policies of training and other programs aimed at offering individuals a wider array of choice, would also be more expensive. But as to whether they are effective enough to justify the costs isn't entirely conclusive.

The simpler approach, and perhaps more reasonable one in the absence of conclusive data is to look for ways the current system can be modified. First and foremost, there needs to be a more perfect experience rating so that it will effectively be more costly for firms to lay workers off unless it is absolutely necessary. Regardless as to which direction the policymaker might be inclined to take, this is something which at a minimum ought to be done. It isn't clear as to how much of a reduction in unemployment this would lead to, but it is believed that it could lead to a reduction. Anderson and Meyer have noted that the "main source of incentives of layoffs on the margin appears to be that the tax rates rise too slowly as benefit payments minus tax payments increase."<sup>(50)</sup> Even if large corporations and multinational firms were to still find it more cost-efficient to pay the higher taxes while still laying off workers, smaller firms might still find it more difficult.

After this, there are perhaps two additional approaches which ought to be taken. One approach is to make adjustments which will alter individual behavior. The other is to make adjustments which will alter firm behavior. Those who see the system as distorting individual behavior, the answer is quite simple: remove the disincentive to leisure and truly motivate those who are laid off to look intensively for work. The chief exponent of this view is Martin Feldstein. At a symposium of the Federal Reserve Bank of Kansas City in August of 1994, Feldstein reasserted a long held position of his; that unemployment insurance and other labor market policies increase the rate of unemployment. If UI isn't to be eliminated altogether, it should be subject to higher taxes, so that the UI net replacement rate will be less. As it currently stands, UI benefits, although it is subject to federal taxation, is not subject to the normal payroll deductions which would include social security, state taxes, and local taxes. As a result, an individual may receive a net replacement rate of more than 60% relative to potential net wages if the same individual was working. This is so despite the fact that gross replacement wages may only be 50%. The answer, then, is to subject UI benefits to more taxation so that it will be less attractive.<sup>(51)</sup> This approach might be reasonable if it can be shown that there are sufficient jobs to go around. But at the same time it seems a little harsh for those who truly cannot find work.

Feldstein actually suggests going a step further, whereby UI benefits would be treated like self-employment income. Then it would be subject to the payroll tax, which would cause them to offset the EITC and other benefit payments. Even more radical than this, he proposes to end giving UI to those who had previously had above average earnings. But he would continue providing a maximum benefit equal to the current average -- about \$200 a week -- which would provide protection while reducing the labor market distortion. Higher income employed individuals would thus be induced to save more as a reserve to supplement their UI benefits. Moreover, he would encourage this by offering tax-favored unemployment savings accounts. This he believes would cost less than the current system.<sup>(52)</sup> There are, however, some problems with this. One is that he offers no real evidence that this would cost the system less. But beyond, one has to wonder just which class he is trying to help. If he believes that the UI system encourages distortions and that high earners shouldn't get any benefits, why is he willing to offer as much as a \$200 a week benefit? In many states, this is still roughly 2/3 the maximum benefit. But if he wants to encourage savings by tax-favored unemployment savings accounts, why would there even be a need to offer a maximum benefit to these individuals at all? On the face of it, this would appear to be contradictory. And yet, one cannot help but wonder whether this isn't another thinly disguised attempt to redistribute benefits from those at the bottom of the income distribution to those at the top. It is hard to escape this conclusion given his desire to tax the benefits of those at the lower end of the distribution so as to offset the so-called distortive effects of the Earned Income Tax Credit (EITC) and other programs. At a minimum, this demonstrates that Feldstein doesn't completely understand the EITC. One only gets a credit if one works and earns income. A low-wage worker who loses a job and thus is no longer entitled to the EITC will have less of a replacement ratio as a function of UI; not more.

At a minimum, the system should be so structured so as to protect the most vulnerable in society. Instead of making individuals bear most of the burden for their unemployment, perhaps public policy should strive to shift the burden to firms. The other approach, then, is to encourage firms to retain workers by adopting work-sharing policies. Although Work Sharing might be more expensive, it might also be more beneficial. It would enable individuals who would otherwise be laid off during a period of economic downturn to continue to be employed. Workers would not only maintain their skills, they would more importantly maintain their dignity. But this, in and of itself, would be no panacea. The fact remains that obsolete industries will still be forced to layoff those whose skills are from a bygone era.

The two directions outlined above are perhaps the simplest adjustments which can be made to the current UI system, without fundamentally altering the purpose it was intended to have. Neither one of them would necessarily obviate the need to offer retraining. But it would represent a positive first step towards reforming the system so that it is brought into the twenty-first century. In time, it may turn out that what is needed is a program which will combine job training with income maintenance. This might require a program which would move us more in the direction of a comprehensive employment program. Such a program would most likely involve greater centralization, rather than less.

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