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Introduction

Good morning. As background for linking the topics of economic growth, economic security, and workforce development policy, I'd like to start by describing the Hamilton Project and its approach to these issues. It is an economic policy initiative that produces research and proposals on how to create a growing economy that benefits more Americans. The Project argues that free markets are efficient and effective but they're not perfect and there is an important role for effective government where markets alone don't work. In an economy where technology and globalization are increasing income inequality and making workers more vulnerable to risk, the Hamilton Project is developing pragmatic policy responses intended to create new opportunities for middle class affluence, bolster economic security, and spur more enduring growth.

The Project is distinguishes itself by relying on innovative thinkers inside and outside Washington, who combine strict academic rigor with a practical understanding of how things work. The Project defines economic issues broadly, not only looking at budget and trade questions, but also at issues like social insurance, technology, and education. Priorities include domestic investments and programs to help workers take risks to boost productivity and wages. The Project advocates for fiscal restraint and an open trade policy, supported by means for distributing the benefits of technology and trade more broadly. The goal in advancing these ideas is not simply to change the debate but to encourage policymakers to change policy and improve our economic prospects moving forward.

The Hamilton Project was formed in response to a shared feeling that the U.S. was on the wrong track economically and that new intellectual energy was needed to develop a serious, systematic strategy to address the challenges the U.S. economy faces. The Project was launched in April of 2006 by a group of business leaders and former policy makers, including former Treasury officials Robert Rubin and Roger Altman. The Project was initially led by Peter Orszag, who recently left to head the U.S. Congressional Budget Office, and is now directed by Jason Furman, who was an economic advisor in the Clinton White House and is currently a Senior Fellow at the Brookings Institution.

To give you a sense of both my own role in this Project and how the Project works, I'll tell you a bit about myself. In 2005 I was teaching at Princeton when Peter Orszag asked me if I had any good policy ideas for addressing the economic insecurity of American workers, and whether I would like to write them up. I became one of the first of a group of scholars now numbering nineteen and growing that have contributed original ideas to the Hamilton Project. As a university professor, my usual style of writing was to define a problem, examine some policy levers that could potentially address the problem, carefully assess the evidence, and end with some general recommendations about the relative effectiveness of different approaches. Working with the Hamilton Project gave me a forum to put forward a single, concrete, comprehensive policy proposal – backed up by a full discussion of the evidence on the pros and cons of the recommended actions. I also benefited greatly from the practical advice of the Hamilton Project's advisors and staff, and from having my proposal reviewed by industry leaders and government officials in addition to academics.

As a contributing author to the Project I don't always agree with the policy proposals made by other authors or with the frameworks advanced in the strategy papers by the Project's advisors, director, and staff. I do know a lot about the project's principles and proposals, which I'll describe to you now – drawing directly on material prepared by the Project's staff as well as from my own work.[1]

First, I'll elaborate on the economic challenges the Hamilton Project aims to address. Second, I'll describe the principles and governing philosophy that guide the Project's work. Finally, I'll share some specific examples of the types of policy ideas that exemplify the Project's approach, focusing on unemployment insurance.

The Challenge

Regarding the challenges, a majority of Americans report they are "worried and concerned" about reaching their economic goals and believe their children will be worse off than they are. Their anxiety is understandable. Despite strong macroeconomic performance, many workers today are not fully sharing in the prosperity of the new global economy and must cope with growing levels of economic risk. Let me briefly discuss each of those two worrisome facts. Growth is not broad-based, and the level of economic risk borne by American families is high.

First, the insecurity of American workers is explained by the nature of economic growth today, which is no longer broadly shared among all Americans as it was for most of our nation's history. Whereas growth in productivity and real median family income roughly tracked each other between 1947 and 1973, those trends have since diverged. Instead, the gains of economic growth have gone largely to those at the top, resulting in a stunning rise in inequality to levels not seen in America since the 1920s. The share of income going to the top 1% families has doubled from 8% in 1980 to 16% in 2004. The gap between the economy's overall performance and income growth for a typical family has been particularly large in the past several years.

Second, economic risks have been shifted onto individuals and away from employers and society as a whole in such areas as health care, retirement security, and job loss. For example, American families face new uncertainties regarding their pensions, as American businesses shift risk to workers by moving from defined-benefit toward defined-contribution retirement plans. In 1980,

[1] In particular, I thank Hamilton Project Policy Director Jason Bordoff for permission to draw extensively from his article entitled "The New Social Compact: A Growth-Enhancing Path to Economic Security," forthcoming in *Democracy: A Journal of Ideas*, and from his remarks to the Vision 2030 Global Forum in Seoul, Korea on February 1, 2007, entitled "Promoting Growth and Opportunity in a Global Economy."

more than one-third of private workers were covered by a government-insured defined-benefit plan; by 2002, that fraction had declined to about one-fifth.

The rapid pace of globalization also exacerbates feelings of insecurity. Although a variety of academic analyses have shown that trade has played only a modest role in domestic job loss and rising inequality, trade can cause painful job dislocations for certain workers even while it is a net benefit to the U.S. economy. The problem is that while the benefits of free trade are diffuse, the concentrated and thus highly visible consequences of job loss in particular industries can lead to anxiety among American workers about globalization.

The Principles of the Hamilton Project

The question then becomes what to do about all of this. In approaching this question, the Hamilton Project is guided by three key principles.

Principle 1: Broad-based economic growth is stronger and more sustainable

The first principle is that economic growth will ultimately be stronger and more sustainable if all individuals have the opportunity to contribute to and benefit from it. When public policy excessively favors relatively few, growth suffers because the nation misses out on much of our potential for innovation and productivity.

In political economy terms, excluding significant parts of the population from the fruits of economic growth also risks a backlash that can threaten prosperity. As Alan Greenspan recently put it, "[A]n increased concentration of income . . . is not the type of thing which a capitalist democratic society can really accept. . . ."

Principle 2: Economic security and economic growth can be mutually reinforcing

The second principle is that economic growth can clearly increase economic security, but economic security can also increase economic growth. Growing economic insecurity for American families takes a toll on the economy as a whole and thus leads to a vicious cycle: insecurity impairs overall growth, which thus increases the likelihood that the well-documented stagnation in real median wages over the past three decades will persist, which in turn exacerbates the economic insecurity that American families face.

Many policymakers and analysts have been trained to believe that providing more security to families must come at the expense of economic performance and that these two goals are thus contradictory objectives. Former Reagan economic advisor Martin Feldstein, for example, has said that social insurance programs "have substantial undesirable effects on incentives and therefore on economic performance. Unemployment insurance programs raise unemployment. Retirement pensions induce earlier retirement and depress saving. And health insurance programs increase medical costs."

This traditional view offers an important caution in designing public policies, but it should not turn into a dogma that ignores other considerations. Especially over the long term, this traditional view misses three key points. Economic security, in fact, can bolster growth in three ways:

First, a basic level of security frees people to take the risks - for example, starting a business, investing in their own education, or trying an unconventional career. Taking these risks can lead to economic growth. With inadequate protection against downside risk, people tend to be overcautious, "fearing to venture out into the rapids where real achievement is possible," as Robert Shiller of Yale has argued. "Brilliant careers go untried because of the fear of economic setback." Second, if hardship does occur, some degree of assistance can provide the resources to help a family thrive again. Families with access to some form of financial assistance, educational and training opportunities, and basic health care are less likely to be permanently harmed by the temporary setbacks that are an inevitable part of a dynamic economy. For families experiencing short-term difficulties, a safety net can thus be a springboard to a better future. Finally, a basic level of economic security can lessen political demands for protectionism and other growth-diminishing policies.

To be sure, the symbiotic relationship between economic security and economic growth is not the only reason we should reduce the likelihood that families will experience economic hardship, and help them rebound if they do. First, there is a moral imperative to provide for the economic well-being of all in society. Viewed from the "original position" described by philosopher John Rawls, this is as much a matter of sharing risk with others as it is one of altruism. Second, as Harvard economist Benjamin Friedman argued in a recent book, providing for the economic well-being of the vast majority of people encourages social progress - "greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy."

Principle 3: Effective government can enhance economic growth

The third principle of the Hamilton Project is that a robust role for government is necessary to allow markets to function effectively, to generate adequate growth-enhancing investments, and to allow all Americans an opportunity to share in that prosperity. As Alexander Hamilton himself wrote, "In matters of industry, human enterprise ought, doubtless, to be left free in the main; not fettered by too much regulation; but practical politicians know that it may be beneficially stimulated by prudent aids and encouragements on the part of the government."

Markets are the cornerstone of economic growth. Yet market forces, while potent, will not by themselves generate adequate investments in education and training. Neither will markets generate sufficient investments in science and infrastructure which are crucial to economic growth.

A robust role for government, however, must also be carefully tailored and well-targeted to be minimize harmful distortions. While increasing economy security, for example, has the ability to promote economic growth, that result is not inevitable. Providing too much security or designing social programs poorly can harm economic growth by excessively blunting incentives to work, innovate, and invest, and some developed nations have gotten the balance wrong in this way. Government policy makers should act carefully but ambitiously in designing programs to increase economic security, recognizing that both the form and the amount of economic security can affect economic growth and individual well-being. In addition, effective government means that policy makers should base decisions on evidence - careful not to spend more on failed programs or in poorly targeted ways that fail to help those most in need. Doing so not only squanders scarce resources, but undermines public faith in government's efficacy.

Four pillars for policy ideas

In short, the Hamilton Project seeks to expand opportunity, increase economic security, and promote growth through the following approach to policy: a robust role for government through smartly designed and well-targeted policies when government intervention is justified, for example due to a market failure, and when there is there is reason based on evidence and experience, not ideology and doctrine, to believe that such government policies will be effective.

The proposals from the Hamilton Project rest upon four pillars: education, innovation and infrastructure, savings and insurance, and effective government. The Project staff have released strategy papers that outline general themes for the project as a whole and in these four areas. A variety of specific proposals have been made.

For education:

- Identifying effective teachers using performance on the job, and basing merit bonus and tenure decisions on this performance
- Providing Summer Opportunity Scholarships for disadvantaged elementary school children to participate in six weeks of academic summer programs
- Dramatically simplifying college financial aid application
- Allowing all disadvantaged children to enroll in a high-quality program of education and care during their first five years, and focusing elementary school spending on programs that have proven effective in improving skills of children

For innovation and technology:

- Increasing fellowship support for American scientists and engineers through the National Science Foundation
- Reducing the number of flawed patents by removing the presumption of validity attached to patents except for those going through a more rigorous process with higher fees
- Expanding the government's use of prizes and advance market commitments for space exploration, agriculture, vaccines for diseases of the poor, energy and climate change, and learning technologies

For saving and insurance:

- Improving opportunities and incentives for saving by middle- and low-income households using automatic enrollment in 401(k) plans and IRAs, and replacing current tax deductions for contributions to tax-preferred retirement accounts with a new program providing universal matching contributions
- Fundamental restructuring of Unemployment Insurance by improving the protection against the long-term effects of job loss through wage-loss insurance and by replacing traditional payments with withdrawals from temporary earnings replacement accounts

- Reforming Unemployment Insurance through setting federal standards requiring states to harmonize their eligibility criteria and benefit levels.
- Creating Universal Insurance to provide short-term, stop-loss protection to qualifying families whose income suddenly declined by 20 percent or more

For effective government:

- Setting a government-wide productivity target; creating an independent entity to obtain and compare data from federal programs; allowing managers to keep a share of productivity gains to bolster front-line services; and enhancing management skills at agencies
- Having the IRS take information about income directly from employers and banks and, if the person's tax status is simple enough, send that taxpayer a return pre-filled with the information.

There are more details on each of the thirteen proposals released thus far at www.hamiltonproject.org. Also, in the next few months the Project will release new proposals on health care and tax reform. The Project is designed in part to provide a forum for leading thinkers to put forward innovative and potentially important economic policy ideas that share the Project's broad goals of promoting economic growth, broad-based participation in growth, and economic security. Authors are invited to express their own ideas in discussion papers, whether or not the Project's staff or advisory council agree with the specific proposals. The Project does not advocate adoption of all of the ideas, and indeed some proposals offer differing solutions to the same problems.

A Case Study: Fundamental Restructuring of Unemployment Insurance

My contribution to the Project has been to propose a fundamental restructuring of unemployment insurance, which I'll describe now to give you a sense of the detail work and use of evidence in Hamilton Project proposal.

As you all know, the dynamic forces of innovation and competition not only fuel the growth of the American economy by also cause turbulence. In 2005, 57 million new jobs began. At the same time, 54 million ended, including 20 million involuntary job losses where people were out of work through no fault of their own. About a third of those involuntarily displaced from their jobs had lower wages over the subsequent ten years.

We have a public policy in place, Unemployment Insurance or "UI," where individuals can typically receive half of their previous weekly earnings for up to six months after a layoff. However, the system encourages layoffs because employers do not bear the true costs. Receipt of UI benefits encourages longer unemployment spells. Moreover, UI provides payments to many people with short unemployment spells who will be re-employed at higher wages, and does not target the resources of the system towards those who are hit the hardest by job loss.

In order to enhance both equity and efficiency after job loss, I have worked with the Hamilton Project to develop a revenue-neutral proposal that improves protection against long-term effects of involuntary job loss, provides a more progressive allocation of benefits, and encourages work.

The proposed reform assists individuals in managing smaller risks, such as short unemployment spells, through savings and borrowing over one's lifetime, while focusing insurance on larger, longer-term shocks to lifetime circumstances.

As part of this reform, the government would create a program of wage-loss insurance for reemployed workers, which would augment the hourly wages of individuals who take jobs that pay a lower wage than their previous job. For example, if someone lost a 14 dollar an hour job and took a new job at 10 dollars an hour, then an insurance payment would be equal to a quarter of the wage loss (or 1 dollar an hour) and would be paid for a period of several years, depending on the work history of the individual and the persistence of the wage loss. The reform proposal could reduce by half the share of permanently laid-off workers experiencing very large drops in wages at their new jobs, from 14 to 7 percent.

As a complement to wage-loss insurance, traditional UI payments would be replaced by withdrawals from temporary earnings replacement accounts, or "TERAs," which would be structured to provide workers with the same ability to maintain living standards during unemployment as does the current UI system. TERAs would provide a mechanism through which workers could accumulate savings prior to unemployment and also borrow against future earnings if they subsequently exhaust those savings. Loans from the accounts could be paid back through withholding from future paychecks. Since most unemployment spells are short, many re-payments can be made quickly. Shifting to TERAs would also remove incentives to prolong unemployment and instead increase the rewards of returning to work, perhaps reducing unemployment durations by 5 to 10 percent.

This systemic reform is explicitly designed to be budget neutral. One-third of revenues contributed to the current UI system, funded by a more progressive payroll tax, would be used for TERA withdrawals for those who make withdrawals and then do not pay back because they have very low wages or they do not return to work after job loss. Two-thirds of revenues contributed to the current system would be used for wage-loss insurance, funded by payments from firms based on the use of the system by their former employees. The proposed system would increase the share of program benefits going to workers in the lower half of the income distribution from 43 percent to 54 percent.

Providing new services without increasing expenditures means that difficult trade-offs must be made. For example, in this proposal those who currently experience temporary layoffs and return to their firm and those who have long unemployment spells followed by wage gains would receive smaller government benefits. A shift from traditional UI to the proposed system would increase the share of resources going to those with long-term wage losses from 34 percent to 61 percent.

This reform, built around wage-loss insurance and TERAs, would be a fundamental shift towards insurance for persistent, long-term effects of job loss. The proposal would continue to provide access to funds needed to maintain living standards after job loss for those experiencing short bouts of unemployment.

The core principle is that smaller, short-term needs can be met through savings, borrowing, and re-payment, so that the funds for insurance can be targeted to assist those facing larger, long-term losses. This new system would also introduce incentives to reduce unemployment by both discouraging temporary layoffs and by creating stronger rewards for finding another job quickly -- ultimately enhancing economic growth.

Prospects for Wage Insurance

Recent press accounts indicate that wage insurance currently has some political momentum. This momentum appears to be behind wage insurance as an addition to the existing UI system, rather than the more fundamental reform I have outlined. Congressman McDermott on the Ways and Means Committee and Senator Schumer on the Joint Economic Committee are crafting a bill to cover almost any displaced worker of any age who loses a job through no fault of their own and takes a new one for lower pay. Workers who make less than $100,000 would be eligible, and with benefits of up to $20,000. One Congressional hearing was held on February 28th and another is being held later today.

There may be scope for states to undertake variations on wage insurance or even to experiment with a form of TERAs on a limited basis. If anyone has an interest in pursuing this, it would be great to talk further after this session. Evidence on the effects of different types of wage insurance replacement rates, benefit durations, and benefit phase-outs would be very valuable. While I believe the case for implementation of a wage insurance policy is strong, the current policy design of Alternative Trade Adjustment Assistance as model for wage insurance has some drawbacks.

One issue in the design of ATAA is the abrupt cut-off of wage insurance payments when earnings on a new job rise above $50,000. In ATAA, someone whose old job paid $70,000 and whose new job paid $50,000 would receive $10,000. If the new job paid $51,000, they would receive no wage insurance at all. This results in higher after-tax income for someone earning exactly $50,000 than for someone earning between $51,000 and $60,000. This is inequitable, and has incentives for individuals to prefer lower earnings in this range. Another key issue is that a worker whose new job is paying less than $37,000 a year will be in the phase-out range of the Earned Income Tax Credit, paying payroll tax, and have wage insurance payments reduced by half for each additional dollar earned. The cumulative effect is a marginal tax rate of over 73 percent, so that the worker's after-tax income increases less than 27 cents for each additional dollar earned. This could have important incentives for workers to choose jobs with higher non-wage compensation and lower wages, and could dilute rewards for promotion and high performance on the job. I think there are strong arguments for conducting research – comparing an ATAA-style policy design to other alternatives, including one having a maximum duration that is longer, a maximum total benefit that is larger, a replacement rate that is lower, and a smoother phase-out of benefits for those with higher earnings – before implementing a broader national wage insurance program.

Conclusion

I'm very interested in your reactions and I look forward to your questions. Thanks.