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A FAIRER DEAL FOR AMERICA'S WORKERS IN A NEW ERA OF OFFSHORING[1]

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Abstract

With a new wave of white-collar offshoring coming fast on the heels of accelerated job losses in manufacturing, an ever-broader pool of American workers is finding that the nation's safety net has more holes than netting. The nation can and must do more to help insure the livelihoods of American workers in the face of structural shifts of whatever form, while preserving the benefits of an open and innovative economy. With technological change and offshoring accelerating job turnover and the pace at which workers' job-specific skills lose value, the time has come for the federal government to strengthen the existing safety net.

We propose a new wage insurance program to provide incentives for more rapid reemployment and on-the-job-training—a program that insures earnings for permanently displaced workers who secure reemployment at lower pay. It would cost roughly $3.5 billion a year to provide permanently displaced full-time workers who secure reemployment with insurance on 50 percent of their earnings loss up to a cap of $10,000 a year for two years. An insurance policy costing $25 per worker per year is a small price to help displaced American workers get back to work more quickly, seek opportunities in new sectors, and gain more valuable reskilling through on-the-job training.

[1] The authors wish to thank Chad Bown, Lori Kletzer, Robert Lawrence, Lawrence Mishel, David

INTRODUCTION

Public anxiety has surged over a new wave of offshoring that for the first time puts white-collar jobs at risk from competition with low-wage foreign providers. White-collar offshoring burst into public consciousness in the middle of a peculiarly unbalanced recovery. The 2001-3 recovery stands out on two counts: the unusually low rate of job creation relative to job destruction, as highlighted by Erica Groshen and Simon Potter,[2] and the "decline in the proportion of that national income going to compensation of employees,"[3] as emphasized by Federal Reserve Chairman Alan Greenspan.

Critics were quick to point to the new wave of white-collar offshoring as a major contributor to the poor performance of the U.S. labor market, although the importance of offshoring relative to productivity growth, the bursting of the IT bubble, and other forces remains murky due to incomplete data.[4] Much more can and should be done to help safeguard the livelihoods of American workers in the face of structural shifts of whatever form – while preserving the benefits of an open economy.

Whether lauded for its remarkable fluidity or lamented for its heartless insecurity, one of the most striking characteristics of the American job market is high job churning. As our colleague, Charles Schultze, has pointed out, apart from cyclical ups and downs, roughly 15 million new jobs are created each year, while another 13 million are destroyed.[5] No other OECD economy comes close.[6] This high turnover rate reflects the vigorous forces of competition in the economy, the creation and death of firms, the growth of some, and the decline of others. The latest wave of white-collar offshoring is the most recent in a longer list of drivers, which includes shifts in consumer tastes, innovation that creates new products and services and makes it possible to produce more with less, new opportunities to

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Richardson, and Howard Rosen for helpful suggestions.

[2] Groshen, Erica L. and Simon Potter. August 2003. "Has Structural Change Contributed to a Jobless Recovery?" *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, Vol. 9, No. 8.

[3] Transcript from Federal Document Clearing House, as distributed by Bloomberg news service, of the question and answer session of the testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, before the Joint Economic Committee, April 21, 2004.

[4] Bosworth, Barry, Lael Brainard, and Susan Collins, Services *Offshoring: What Do the Data Tell Us?* June 22, 2004, http://www.brookings.edu/dybdocroot/pge/20040622summaryfinal.pdf.

[5] Charles Schultze, "Offshoring, Import Competition, and the Jobless Recovery," (Washington: The Brookings Institution, 2004).

[6] OECD, *The OECD Jobs Study: Facts Analysis, Strategies*, Paris, 1994.

outsource elements of the business system domestically and overseas, competition from imports, and job opportunities associated with rising exports.

To a greater degree than many other advanced economies**,** the United States is characterized by the process of "creative destruction" so memorably described by the late, great Harvard economist Joseph Schumpeter. The term succinctly captures the two faces of a market economy. Living standards will not grow, according to Schumpeter and a long line of economists who have made similar arguments since, unless change is not only tolerated but actively nurtured. Indeed, alongside high job turnover, the U.S. economy has enjoyed a surge of productivity growth over the past decade. Productivity has increased at a roughly 3 percent annual pace since 1995, more than double the anemic 1.4 percent pace of the preceding two decades. But as Schumpeter's term also acknowledges, the downside of market-driven dynamism is "destruction." Firms that do not pass the market test shrink or go out of business, destroying the livelihoods of employees and owners alike.

Since the great Depression, America has recognized some collective responsibility to help those who, through no fault of their own, may be thrown of out a job. The main instrument is federally mandated unemployment insurance (UI), which replaces a portion of an unemployed worker's previous wage for up to 26 weeks. Since 1962, the social contract has also included special protections for those displaced by trade, including extended unemployment insurance and retraining benefits. The Trade Adjustment Assistance (TAA) program was intended to partially offset the distributive consequences of trade liberalization, which exposes workers in import-competing sectors to job loss and often permanent reductions in lifetime earnings, even as it delivers benefits to consumers as well as workers and businesses in export sectors.

For too many, however, the nation's safety net has more holes than netting. For example, the main UI program has multiple restrictions so that today only about 40 percent of all unemployed workers actually receive benefits. Meanwhile, it has long been difficult, time-consuming, and expensive for workers to prove they are entitled to extended unemployment benefits under TAA. Since the program was last reformed in 2002, for example, it has helped fewer than 75,000 new workers a year, while denying more than 40 percent of all petitions (see Table 1).[7] Further, there is little evidence that the training

[7] Source: Department of Labor. http://www.doleta.gov/tradeact/taa_stats.cfm

requirement under the program is effective. To be sure, some workers get new jobs after retraining, but many others are required to enter retraining to receive extended income support only to find no job in their new specialty at the end of the program. For some, TAA may actually delay reentry into the workforce without providing a commensurate improvement in earnings prospects. And remarkably, the Department of Labor has interpreted the TAA statute as excluding the growing number of services workers displaced by trade, which is currently being disputed in court.

With offshoring accelerating the pace at which workers' investments in job-specific skills lose value, the time has come for the federal government to supplement existing efforts with a new insurance program that encourages rapid reemployment and insures wages, not just unemployment, for permanently displaced workers. By providing insurance against wage losses, wage insurance encourages workers to move back into employment more quickly, while defraying the cost to employers of hiring and training a new employee. Rather than paying for compulsory retraining that is not directly connected to a job opening and may never be put to use, wage insurance defrays the cost to employers of providing on-the-job training to new hires. The economy benefits from lower unemployment durations and more efficient retooling for workers. We and others have made the case for wage insurance previously, and we are pleased that it has just been endorsed by the Committee for Economic Development.[8]

Below we make the case that wage insurance is particularly well-suited to address the new wave of offshoring of white collar work and explain why it must be publicly mandated to be effective rather than left to private provision. We make recommendations on program design, compare per worker costs for wage insurance relative to existing programs and alternative proposals, and provide aggregate cost estimates for different versions of the program, using the latest data on displaced workers published by the Department of Labor. Finally, we argue that wage insurance should be attractive to both sides of the political spectrum even in these times of budgetary stress.

[8] For earlier presentations of the idea. see Lori Kletzer and Robert E. Litan, "A Prescription for Worker Anxiety," *Brookings Policy Brief No. 73*, March 2001; Gary Burtless and Robert Litan *Globaphobia Revisited: Open Trade and Its Critics*, The Brookings Institution, 2001; Lael Brainard and Robert E. Litan, "'Offshoring' Service Jobs: Bane or Boon and What to Do?", *Brookings Policy Brief No.132*, April 2004, and Lael Brainard, *Protecting Losers: Optimal Diversification, Insurance, and Trade Policy*, NBER Working

ASSESSING EXISTING UNEMPLOYMENT AND TRADE ADJUSTMENT PROGRAMS

America's safety net is miserly by comparison with almost every other advanced economy in the world. Not only are unemployment benefits of relatively shorter duration, but America's heavy reliance on employer-based insurance means that displaced workers face the prospect of losing health and retirement benefits along with income when they are thrown out of work. The consequences of job loss are particularly damaging to workers with some seniority in import-competing industries, where it has been documented that workers face more protracted spells of unemployment and greater permanent earnings declines than other displaced workers.

The UI program is the mainstay of America's safety net, providing benefits of roughly $260 per week on average for up to 26 weeks – a period that is often extended during recessions through temporary legislation.[9] It is funded through a combination of federal and state payroll taxes.

President Kennedy established the TAA program in 1962 as a central part of the social contract on trade. It is intended to compensate workers who suffer job loss as a result of trade liberalization that otherwise brings gains to the economy overall. Whereas the theory of economic trade is broadly reassuring that the gains from trade liberalization are sufficient to compensate the losers *in principle*, TAA -- however imperfect -- is the closest mechanism we have to undertake such compensation *in practice*.

In 2002, Congress enacted a major overhaul and expansion of TAA that added a health-care tax credit, doubled the training budget, and substantially raised budget outlays for income support. Key changes included expanding eligibility beyond manufacturing to agricultural workers as well as workers displaced by a shift of production overseas, and so-called "secondary workers"— those indirectly affected by international trade by virtue of being suppliers to plants directly hurt by trade. Coverage of workers enrolled in the program was extended by 26 weeks, offering up to 104 weeks of income support and up to 78 weeks of training, job search, and relocation support to eligible participants.

Paper No. 3773, 1991. See also Committee for Economic Development, *From Protest to Progress: Addressing Labor and Environmental Conditions through Freer Trade*, 2001.

[9] Congressional Budget Office, *Family Income of Unemployment Insurance Recipients*, March 2004.

Despite this, implementation of the TAA program continues to disappoint. The certification process is burdensome and unpredictable. For those few workers who do participate, training is under-funded and often ineffective, and program participants experience long delays before securing jobs that often pay substantially less than previous positions.[10]

Even after the important 2002 expansion, participation in the program has remained surprisingly low. Although there was a sharp increase in certifications in 2002, the U.S. General Accounting Office (GAO) concluded that it was caused by the sharp decline in manufacturing employment that preceded the implementation of the 2002 Act rather than the legislative changes. As shown in Table 1, nearly half of all petitions were denied in 2003, and less than one quarter of those certified eligible actually were granted income support. The low participation rate reflects in part confusing Department of Labor practices that ultimately deny benefits to roughly three quarters of the workers who they certify as eligible for TAA.

Table 1: TAA CERTIFICATION, DENIALS AND ENROLLMENT, 2000-2004

	2000	**2001**	**2002**	**2003**	**2004**
Petitions	1,382	2,353	2,404	3,564	2,918
Percent Certified	61%	44%	69%	53%	59%
Number of Workers Certified	98,007	139,587	235,072	197,264	147,956
Number of Workers Denied	53,433	59,067	74,760	91,585	55,295
New Income Support Recipients	32,808	31,459	37,426	43,007	74,865
Percent of Newly Certified Receiving Income Support	34%	23%	16%	22%	51%
New Training Recipients	22,665	24,843	37,186	43,444	46,536
Percent Newly Certified Receiving Training	23%	18%	16%	22%	31%
New ATAA Recipients*	NA	NA	NA	288	1,115

[10] See "Trade Adjustment Assistance: Reforms have Accelerated Training Enrollment, but Implementation Challenges Remain," GAO-04-1012 and Lori G. Kletzer and Howard Rosen, "Easing the Adjustment Burden on US Workers," IIE, 2005 for in-depth evaluations of the changes to TAA.

Note: Not all workers certified under an approved TAA petition are individually eligible for TAA benefits and services.

*Authors' calculations based on DOL data.

Source: Department of Labor

In eight cases involving hundreds of workers, where the Department of Labor denied eligibility for TAA, U.S. judges have overturned the decisions on the grounds that the Department's interpretation of eligibility requirements was overly restrictive.[11] And the language of court decisions has become increasingly critical. In a recent case, the U.S. Court of International Trade stated "this case stands as a monument to the flaws and dysfunctions in the Labor Department's administration of the nation's trade adjustment assistance laws…"[12]

Moreover, funding for training under TAA remains woefully inadequate. As shown in Table 1, the number of participants entering training nearly doubled between 2002 and 2003 due to the plunge in manufacturing employment. Despite the 2002 increase in training caps, demand continues to exceed the budget cap significantly. According to the GAO: "States have struggled to meet higher demand with the TAA training funds available to them, even though TAA training funds available nationally doubled between fiscal years 2002 and 2003...19 states temporarily discontinued enrolling TAA eligible workers at some point between 2001 and 2003 because they lacked adequate training funds, and six states have taken this step during fiscal year 2004."[13] Interestingly, this shortfall was projected during the congressional debate on TAA in 2002, but efforts to raise the cap adequately were rejected by Congress. Partly as a result, the number of workers not receiving training benefits rose by 1/3 in 2003, and, as shown in Table 1, now stands at 2/3 of newly certified workers.[14] This trend effectively makes the TAA program one of extended unemployment insurance rather than an active reemployment program.

The Department of Labor's restrictive interpretation of eligibility requirements for income support coupled with the ongoing inadequacy of training funds help to explain why

[11] "Trade Adjustment Assistance: Reforms have Accelerated Training Enrollment, but Implementation Challenges Remain," GAO-04-1012, p. 53.

[12] "The Bush Record on Shipping Jobs Overseas,"AFL-CIO Issue Brief, August 2004.

[13] See "Trade Adjustment Assistance: Reforms have Accelerated Training Enrollment, but Implementation Challenges Remain," GAO-04-1012. P.4.

[14] Department of Labor.

recent outlays for TAA income support are far below available authority, while training outlays fully exhaust the available budget authority, as shown in Table 2.

Table 2: TRADE ADJUSTMENT ASSISTANCE BUDGET AUTHORITY AND OUTLAYS*

$ Millions

	2000	2001	2002	2003	2004	2005**	2006**
Income Support and Benefits							
Authority	283	275	284	713	1079	798	707
Outlays	272	259	249	339	520	637	707
Training							
Authority	132	132	132	259	259	259	259
Outlays	133	141	142	212	179	243	259
ATAA* **							
Authority	n/a	n/a	n/a	n/a	10	48	52
Outlays	n/a	n/a	n/a	n/a	2.2	48	52

*Actual budget authority, estimated outlays. Includes NAFTA-TAA training, income support, and benefits after the program was merged with TAA starting in 2003.
** Administration request.
*** ATAA initiated in 2003
Source: OMB.

Finally, despite the laudable goals of the TAA program, beneficiaries continue to achieve disappointing rates of reemployment and levels of earnings. As shown in Table 3, between 2001 and 2004, an average of only 64 percent of participants found reemployment during their participation in TAA. Job retention by workers – defined as those employed in the first quarter after program exit that remained employed for at least two additional quarters – remained constant between 2001 and 2004. And the wage loss for those workers who secured reemployment rose sharply from 13 percent in 2001 to 26 percent in 2004.

Table 3: TRADE ADJUSTMENT ASSISTANCE REEMPLOYMENT AND EARNINGS OUTCOMES*

	2001-2004			
	2001	**2002**	**2003**	**2004**
Wage Loss	13%	20%	27%	26%
Estimated Salary Following TAA Enrollment	$24,512	$25,600	$27,260	$29,668
Reemployment Rate	63%	66%	62%	63%
Job Retention Rate	89%	89%	86%	89%

* Combines results for TAA and NAFTA TAA until the programs were merged in 2003.
Source: Department Of Labor.

The hardest fought expansion in the 2002 TAA reform was the inclusion of a tax credit for health insurance, the Health Coverage Tax Credit (HCTC), in recognition that trade-displaced workers often suffer not only from permanently lower earnings but also loss of health care coverage. The HCTC pays 65 percent of health insurance premiums through a fully refundable tax credit, so that even individuals who owe little or no federal income tax benefit get some benefit. The tax credit was also made "advanceable" beginning in August 2003, allowing direct payment of the credits to insurers on a monthly basis when the premiums are due, rather than postponing the reimbursement until an end-of-the-year tax refund, an unmanageable burden for many displaced workers.

Early implementation of the HCTC revealed a daunting set of obstacles and a disappointing take-up rate. The GAO reports that fewer than 8,000 TAA beneficiaries were enrolled in the HCTC as of July 2004, which represents less than 6 percent of individuals certified under TAA.[15] The GAO cites a number of reasons for the low take-up rate, including the "fragmentation and complexity of eligibility determination and enrollment process, which required individuals to navigate steps that involve multiple federal and state agencies and to meet specific tax, labor, and health coverage requirements."[16] For most enrollees there is a 3- to 6-month process for completing enrollment requirements, during which time unemployed individuals must pay out of pocket for coverage or risk a lapse of more than 63 days, which would invalidate consumer legal protections such as guaranteed

[15] "Health Coverage Tax Credit: Simplified and More Timely Enrollment Process Could Increase Participation", GAO-04-1029, September 2004.

acceptance by a health plan despite preexisting medical conditions. And finally, it quickly became apparent that even a 35 percent share of the annual premiums was out of reach for a large number of displaced workers. According to the GAO, the 35 percent share of premiums absorbs about 25 percent of the average monthly TAA income support for a couple and about 13 percent for a single individual.[17]

Finally, despite the many laudable changes in the 2002 TAA reform, it quickly became clear that TAA remained woefully out of step with current economic realities as the debate over white collar offshoring jobs heated up. During the 2002 debate over TAA reform, the congressional majority rejected a strong push by some far-sighted members to explicitly expand coverage to services workers. And the Department of Labor hewed to a restrictive interpretation of the statutory eligibility criteria in rejected a petition for coverage by IT workers—a decision that is currently being contested. With the rapid spread of globalization through the hitherto largely nontradeable services sector, these decisions effectively shrank the nation's safety net to an ever smaller portion of at-risk workers.

WHY WAGE INSURANCE?

A main purpose of wage insurance is to accelerate the pace at which permanently displaced workers are reemployed. Wage insurance is more likely to have overall positive economic benefits if it is targeted to workers who would otherwise suffer a significant earnings loss due to an exogenous drop in the value of job-specific skills. These workers have the greatest incentive to prolong their search before accepting employment at a lower wage scale in the hopes of regaining their former earning power and – and possibly at the margin because their unemployment benefits are higher relative to earnings foregone. As documented in Table 4, trade-displaced workers tend to suffer earnings losses of nearly one fourth in annual earnings following reemployment, compared with one sixth for displaced workers overall, and to remain unemployed more than three times longer.

The spread of offshoring to white-collar work would seem to accelerate the pace at which firm specific skill investments undertaken by affected workers diminish in value. This puts a special premium on the second critical value of wage insurance: it acts like a

[16] GAO, page 5.

training subsidy for new employer. The retraining that displaced workers receive on a new job is the best kind – providing new skills that contribute directly to performance in the new job, and are thus directly useful to both the new employer and employee. This is in sharp contrast to generalized retraining programs, such as those available under TAA, which cannot guarantee a worker a job at the end and thus could be of limited value, while costing the worker the wages that he or she might otherwise earn if reemployed sooner. This implicit on-the-job training subsidy may be of particular relevance to workers who retain valuable general skills even when their firm specific skills decline in value.

Finally, wage insurance has been shown to encourage workers to seek out new types of jobs and jobs in different sectors. This is particularly valuable for permanently displaced workers who have suffered a loss in the return to skills that were specific to their previous type of job or sector.

Carl Davidson and Stephen Woodbury provide a formal model to explore the effects of a generalized wage subsidy. They model a wage subsidy program in which a dislocated worker who becomes reemployed would receive a payment equal to one-half the difference between the wage previously earned and the wage currently earned – examining the cases where the subsidy is paid in perpetuity, and one that is limited to the 2 years following reemployment.[18] The wage subsidy provides incentives for dislocated workers to search harder for jobs and accept employment that they might otherwise refuse, and thereby shortens their duration of unemployment and increases their employment and lifetime earnings. Both private and social benefits derive from the policy: output increases, workers' general skills are maintained, and new skills are acquired on-the-job. The costs of the wage subsidy are (at least partially) offset by reduced spending on public income support and generalized training programs. For the economy overall, wage insurance results in a small increase in overall steady-state employment: more of the total available jobs are filled as dislocated workers are induced to search harder for and accept jobs that would otherwise have remained vacant. They also find that employment levels rise for dislocated workers, which is only partially offset by lower employment levels for other

[17] GAO page 5.

[18] Davidson, Carl and Stephen Woodbury. "Wage-Rate Subsidies for Dislocated Workers." *Upjohn Institute Staff Working Paper* 94-28. Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research, January 1995.

workers whose search intensity falls.

HOW HAS WAGE INSURANCE PERFORMED IN PRACTICE?

Several labor market programs contain important elements of wage insurance and provide useful lessons for program design. Perhaps the closest analogue of the program we propose below is a pilot program undertaken in Canada in 1995-96. Approximately 6,000 displaced workers received supplement payments of 75 percent of their loss in earnings for up to two years up to a maximum compensation of $13,000 per year. An assessment based on randomized trial methodology found that the program reduced unemployment duration s by 4.4 percent on average.[19] This seemingly modest result would amount to roughly $450 million in annual savings on unemployment insurance payments in the US context. The incentive effect could be amplified by counting the weeks of unemployment against the two-year maximum compensation period as discussed below, which was not done in the Canadian case. Second, there was strong evidence that the presence of wage insurance did not make workers any more likely to accept the first job they found, allaying potential concerns about the efficiency and durability of job matches. Third, there was clear evidence that wage insurance encouraged workers to consider new types of jobs, including those in other sectors, and thus broadened the job search.

In the U.S., perhaps the best-known ongoing program with an earnings insurance dimension is the Earned Income Tax Credit (EITC), which effectively subsidizes the earnings of low-income households through refundable tax credits. It is an employee-based subsidy, implemented through the tax code, and strictly targeted on poverty. The substantial literature assessing the effectiveness of the EITC concludes that it has been effective at expanding the labor force participation of low-income workers and at moving

[19] Howard Bloom, Saul Schwartz, Susanna Lui-Gurr and Suk-Won Lee, *Testing a Re-employment Incentive for Displaced Workers* (SRDC, 1999).

several million households out of poverty. However, since the program is not limited to full-time workers, and since the subsidy phases out as income rises, it has also led to some reduction in hours for workers with earnings near the phase-out.[20]

Research on the Targeted Jobs Tax Credit (TJTC) by Katz and others highlights participation rates as low as 9 percent of eligible workers. The literature suggests the low participation rates are primarily a function of stigma and reluctance to self-identify as a member of the target population due to perceptions of lesser quality and skills. Second, burdensome certification and eligibility requirements restricted the pool of employers applying for the credit. Despite low participation rates, the research finds an improvement in labor force participation rates of the targeted populations.[21]

The New Jobs Tax Credit wage subsidy program of 1977-8 also provides some interesting lessons. This employer-based program provided a one-year wage subsidy for new hires. It was intended as a counter-cyclical measure and thus limited to two years. Research by Perloff and Wachter is consistent with findings on other programs that implementing subsidies through employers makes participation highly dependent on employers' knowledge of the program and capacity for establishing eligibility. They conclude the NJTC was not particularly effective as a counter-cyclical program and attribute its limited impact to its temporary nature. However, they also find that it significantly boosted employment for those firms that participated relative to those that were unaware of the program.[22]

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[20] Dickert-Conlin, Stacy and Douglas Holtz-Eakin, 1999. "Employee-Based versus Employer-Based Subsidies to Low-Wage Workers: A Public Finance Perspective," JCPR Working Papers 79, Northwestern University/University of Chicago Joint Center for Poverty Research. Dickert, Stacy, S. Hauser, and J. K. Scholz. 1995. "The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation," in James M. Poterba, ed., Tax Policy and the Economy, Vol. 9. Cambridge, MA: MIT Press. Eissa, Nada and Jeffrey B. Liebman. 1996. "Labor Supply Response to the Earned Income Tax Credit," Quarterly Journal of Economics, 111(2) (May): 605-37., Meyers, Bruce and Dan Rosenbaum. 1997. "Welfare, the EITC, and the Labor Supply of Single Mothers," working paper. Chicago, IL: Northwestern University, November. Eissa, Nada and Hilary Hoynes. 1998. "The Earned Income Tax Credit and The Labor Supply of Married Couples," NBER Working Paper No. W6856. Cambridge, MA: National Bureau of Economic Research, December. And Liebman, Jeffrey B. 1993. "The Impact of the Earned Income Tax Credit on Incentives and Income Distribution." In James Poterba (ed.), Tax Policy and the Economy, Vol. 12, pp. 83-119.

[21] Bishop J., and S. Kang. 1991. "Applying for Entitlements: Employers and the Targeted Jobs Tax Credit." Journal of Public Policy Analysis and Management 10 (1): 24–45. Katz, Lawrence. 1996. "Wage Subsidies for the Disadvantaged," NBER Working Paper 5679. Cambridge, MA: National Bureau of Economic Research, July.

[22] Perloff, Jeffrey M., and Michael L. Wachter, "The New Jobs Tax Credit: An Evaluation of the 1977-78 Wage Subsidy Program," *The American Economic Review*, Volume 69, No. 2, Papers and Proceedings.

There are also a number of wage subsidies currently in place, which are implemented through employers at the state and federal level, such as the Work Opportunity Tax Credit (WOTC) and the Welfare to Work Tax Credit (WTWTC). These programs share some of the features of the wage insurance program we will propose below, namely employers must hire the workers within a limited time period and they cannot be rehires. However, they differ importantly in targeting groups of workers that are at risk for poor labor force outcomes, such as welfare recipients, felons, veterans, and at-risk youths.

It is likely that the program underestimates of the economic benefits of a wage insurance program. The pilot program was in place for only a year and none of those chosen for the experiment would have known about it beforehand. A permanent program, known widely, in our view would be viewed differently, and take-up rates and responses to the incentives under the program would be greater.

One key lesson from both the tax credit and wage insurance program experience is that a tradeoff exists between targeting and participation rates. The more targeted the program, the more cost-effective it should be in principle at moving the target population into employment faster. However, the targeting comes at the expense of burdensome eligibility and compliance requirements as well as possible stigma that lower participation rates to strikingly low levels. The only exception to this appears to be targeting by income level, which can be implemented through the personal income tax system rather than through a system that depends on employer certification. This argues strongly for a less targeted program that is implemented through an existing system with proven efficacy, such as the UI system, rather than the burdensome TAA system.

ATAA

Most recently, Congress adopted a small and quite restrictive wage-insurance benefit targeted at trade displaced workers in the TAA overhaul of 2002. Although the original proposal was laudable, strong resistance resulted in a program that was overly restrictive in scope, and implementation has been nothing short of embarrassing. The so-called Alternative TAA (ATAA) program is supposed to provide limited wage insurance for workers who are over 50 with incomes at or below $50,000, who obtain reemployment within 26 weeks at a lower rate of pay. The benefit provides 50 percent of the difference

between the participant's earnings in their old and new jobs (for those suffering a loss) up to a maximum of $10,000 over 2 years.

Early implementation has been disappointing. As shown in Table 1, only an estimated 288 participants were enrolled in ATAA in 2003, compared with over 43,000 newly eligible participants in TAA. This reflects a combination of poor implementation — fewer than half of the states implemented the ATAA program by 2003 – and poorly defined eligibility criteria.

The ATAA program should not be viewed as a defining pilot wage insurance program for trade-displaced workers because the eligibility criteria are so badly defined. Eligibility is restricted to workers that "lack easily transferable skills" and yet nevertheless find reemployment within 26 weeks.[23] The objective is to help workers **"**for whom retraining may not be appropriate"[24] return to work as quickly as possible. In sharp contrast, we believe that wage insurance is particularly well-suited for workers who retain valuable general skills but may no longer earn a premium on a set of occupation- or job-specific skills that have lost value due to shifts in demand, technology, or foreign competition. While the ATAA's biggest flaw is the restriction to workers that lack easily transferable skills, which complicates eligibility enormously, we would contend the under 50/ over 50 restrictions are also counterproductive. There is a compelling case for making wage insurance available to mid-career workers who retail valuable general skills and those in higher income ranges (albeit with a cap).

PRIVATE PROVISION?

A widely cited study of offshoring in 2003 by McKinsey & Co. suggested that firms voluntarily offer wage insurance as a benefit to their workers, and estimated it would cost no more than 5 percent of the savings firms realize from offshoring.[25] Effectively, this proposal asks firms to promise a kind of severance program to workers as a condition of the employment contract.

We are not opposed to the idea but suggest its limitations. For one thing, wage

[23] GAO-04-1012
[24] See Department of Labor. http://www.doleta.gov/tradeact/benefits.cfm
[25] Vivek Agrawal and Diana Farrell, "Who Wins In Offshoring," *McKinsey Quarterly*, 2003 Special Edition, pp. 37-41.

insurance is a cost-effective response not only to offshoring but to all sources of permanent displacement, many of which have nothing to do with cost savings. For example, firms may lay off workers because demand for their products has shifted away, or because a new technology has displaced their core business model. There are no "savings" from these events out of which firms could finance wage insurance.

More broadly, a firm facing intense competition – and which firms aren't these days? – almost certainly would "pay" for any wage insurance it offers by reducing the workers' cash salaries by the estimated cost of the program. Workers who have a choice between firms that offered the insurance and firms that didn't might not view the insurance to be of sufficient value, thinking like many who live in earthquake zones: displacement is unlikely to happen to me, so why should I accept lower wages to pay for it? Fearing this outcome, firms may be reluctant to add the benefit, even though it may be valued for some potential job-seekers. Moreover, if wage insurance were voluntary on the part of employers, those who offered the benefit in effect might be reluctant to be seen as signaling to future hires that their tenure might be abruptly curtailed.

For both of these reasons, we are doubtful that the market, left on its own, will provide wage insurance to any more than a small portion of the labor force. As a result, a broad range of workers who might lose their jobs for any number of reasons during their careers, and many if not most workers will at some point, will not be able to obtain wage insurance of the type we have outlined.

Might insurance companies step in to fill this market need? We suspect not, for a simple reason that economists call "adverse selection". Insurers are likely to surmise that those who most want the insurance are also those most likely to be serially unemployed and charge premiums accordingly. How otherwise can one account for the fact no insurer has yet stepped forward to supply the insurance? Of course, the same was true of unemployment insurance: before the government provided unemployment insurance, insurers weren't providing it either. Only government, therefore, is likely to address these "market failures" in the labor market.

KEY DESIGN CHOICES

The key design variables for a wage insurance program are:

- The target population;
- The duration of the insurance payments;
- The wage loss replacement rate; and
- The maximum total compensation.

We would recommend targeting the program on permanently displaced workers who have achieved some seniority at the previous job, for instance at least two-years experience, defined as "long-tenure" workers in BLS data. We use the definition of "displacement" from the Labor Department Displaced Worker Survey: those who lose their jobs because their plant or company closed or moved, there was insufficient work for them to do, or their position or shift was abolished. We would also recommend restricting the program to workers that were displaced from full-time jobs and reemployed full-time, so as to avoid any possible incentive to reduce hours of work.

There are compelling reasons to offer wage insurance to all full-time permanently displaced workers rather than restricting it to trade-displaced workers. First, most job displacement occurs due to causes other than trade—such as technology change and shifts in consumer demands. Indeed, for many occupations, it is difficult to disentangle the effects of trade and technology. In the most recent wave of offshoring, Frank Levy and Richard Murnane conclude that the jobs most vulnerable to offshoring are also the most codifiable and thus susceptible to automation. Moreover, it matters little to the displaced worker what has caused his or her misfortune. Nor should it matter for social policy; technological shifts can be as redistributive as shifts in trade. Finally, the administrative requirements for limiting benefits to trade-displaced workers, as well as the process of establishing eligibility, would severely undermine effectiveness, as with TAA.

We would further recommend limiting the compensation period to the first two years, when on-the-job-training is arguably most concentrated – and to begin only once the worker actually landed a new job. (Below we also show cost estimates for a one year program.) That way, displaced workers would have greater incentives to accelerate

accepting a new job (which might reduce the cost of unemployment insurance somewhat), even if it paid somewhat less than the one he or she were earning before.

For TAA-eligible workers, the incentive to use the wage insurance program instead of entering or continuing in TAA could be reinforced by triggering the two-year period for compensation at the earlier of entry into a new job or at 26 weeks. By doing this, the total remaining compensation under wage insurance would decline with each week of unemployment beyond the 26-week window. For other workers, the 26-week trigger would simply reinforce the benefit of entering into employment more rapidly.

The choices of the replacement rate and the annual cap on compensation matter centrally for determining what kinds of workers are most likely to benefit from the program. For instance, the combination of a high replacement rate and low annual compensation cap would provide the greatest benefits to lower income workers suffering a steep loss in earnings loss, while a lower replacement rate with a high annual cap would tilt compensation towards higher earnings.

Program costs are very sensitive to the choice of the replacement rate and the cap on insurance payments relative to the earnings losses of the eligible population. Table 4 compares average earnings, earnings losses, and unemployment durations for displaced workers certified by TAA with displaced workers in manufacturing overall, services overall, and the services activities that appear to be most vulnerable to offshoring. A few interesting facts stand out. In those services sectors potentially most affected by offshoring, earnings prior to displacement are 51 percent higher compared with the overall manufacturing sector, where trade adjustment programs have traditionally focused. And although the percentage earnings loss is more modest for offshoring-susceptible services than for manufacturing, the absolute earnings loss is greater.

Table 4: DISPLACED WORKERS:
PRIOR EARNINGS, EARNINGS LOSSES, AND UNEMPLOYMENT DURATIONS,
2001-2003 AVERAGES

	Full-Time Workers Displaced Thousands	Average Earnings on Lost Job	Change in Earnings in New Job	Average Weeks without Work

Trade Displaced (TAA)*	71,000	$32,505	-21 %	80**
Total Displaced	2,068,000	$42,687	-16%	11.9
Manufacturing Displaced	693,000	$40,154	-20%	14.1
Services Displaced	953,000	$45,479	-13%	10.5
Services Potentially Affected by Offshoring	205,000	$60,535	-14%	13.1
Telecommunications	77,674	$52,830	-26%	14.7
ISP, Data Processing, & Other Info Services	9,000	$62,366	-24%	-
Architectural, Engineering, & Related Services	41,000	$61,058	-16%	18.7
Computer Systems Design & Related Services	75,000	$65,921	-6%	14.5

Note: Table Refers to Full-Time Workers with at least 2-year tenure.
*TAA displaced worker estimate based on entire TAA population. Earnings estimates of TAA displaced workers based on those that completed the program.
** Author's calculations based on TAA data.
Source: Department of Labor, BLS.

Trade-displaced workers certified under TAA stand out in Table 4 relative to all other categories of workers as having substantially lower earnings than displaced workers in services and manufacturing overall, the greatest losses relative to prior earnings, and the longest unemployment durations. This highlights an important question for the overall cost of a wage insurance program and the complexity of implementation: whether to target the program only to trade-displaced workers or the universe of permanently displaced workers. Most economists would argue that a program such as wage insurance should be available to all permanently displaced workers, for whatever reason, whether related to trade, offshoring, technology, or shifts in consumer demands. It doesn't matter to the displaced worker which of these causes is responsible for his or her misfortune. Nor should it matter for social policy; technological shifts are potentially as redistributive as shifts in trade. Second, the administrative requirements for limiting benefits to trade-displaced workers, as well as the process of establishing eligibility, would severely undermine effectiveness, as with TAA.

Table 5 compares the costs and benefits for the average displaced worker of a wage insurance program that replaces 50 percent of earnings losses up to a maximum of $10,000 with UI, TAA, and a variety of other proposals (a broader range of program specifications

is assessed in our aggregate cost estimates in the section below). Even if the maximum benefit is doubled from the current allowable under ATAA, our wage insurance proposal compares very favorably with the cost of TAA, and indeed falls midway between the current unemployment and retraining benefits available under UI and WIA and the all-in cost of TAA benefits.

The Bush administration and some members of Congress have proposed Personal Reemployment Accounts (PRAs), which are essentially a cheaper alternative to the benefits currently available under WIA. The proposed PRAs would provide a voucher for $3,000 to workers who were likely to exhaust their UI benefits. The vouchers could be used to purchase reemployment services such as counseling and training, to extend unemployment benefits, or, for those who find employment within 13 weeks, unused benefits could be distributed as income – with 60 percent (up to $1,800) distributed at the time of accepting the job and the remainder (up to $1,200) distributed following six months on the job. As Andrew Stettner and Amy Chasanov point out, however, the PRA is starkly inferior as a training subsidy compared to existing federally funded training vouchers, which amount to $10,000 per worker.[26] And they cite Department of Labor research by Christopher O'Leary and Randall Eberts, which predicts that "PRA recipients might therefore reduce use of [training and counseling] services in hopes of receiving larger reemployment bonuses" and highlights "the incentive for some claimants to accept low-paying jobs simply to qualify for the first bonus paid upon reemployment,"[27] which could result in short-duration matches and diminish the prospects for on-the-job training.

Although the maximum compensation under our wage insurance proposal is much greater than the proposed PRA, it should also deliver much greater overall economic benefits. Those include more efficient and more durable job matches and incentives for companies to invest in the skills of new hires over a two-year period.

One important question is whether wage insurance recipients would continue to have access to the HCTC during the two years they receive wage insurance, with the new

[26] Stettner, Andrew, and Amy Chasanov, "Setting the Wrong Course: Personal Reemployment Accounts Fail to Address the Real Needs of Jobless Workers," Economic Policy Institute, 2004.
[27] O'Leary, Christopher J. and Randall W. Eberts, "Personal Reemployment Accounts: Simulations for Planning Implementation," W.E. Upjohn Institute for Employment Research, U.S. Department of Labor ETA Occasional Paper 2004-08, May 2004.

employers possibly picking up the employee share of premium coverage. The advantage of such an approach would be to ensure continuous health coverage for workers as they move between jobs, while further lowering the initial costs of hiring to an employer who would otherwise provide health care coverage to its employees. The downside, of course, is an increase of roughly one quarter to the per-worker cost of wage insurance. While the overall cost of health care enhanced wage insurance would still compare quite favorably with TAA, the gap with UI would widen considerably.

Table 5: COSTS PER WORKER UNDER ALTERNATIVE ADJUSTMENT PROGRAMS

Program	**TAA**	**UI and WIA**	**ATAA Wage Insurance**	**Brainard Litan Warren Proposal**	**Bush PRAs**	**Skill-Improve-ment Tax Credit**
Maximum Duration	**1½ Years**	**1/2 Year**	**2 Years**	**2 Years**	**1 Year**	**5 Years**
Maximum/Average Benefit per Worker						
Employer-Sponsored Training	-	-	-	-	-	Max. of $5,000
Total Average Income Maintenance Payments	$19,300	$6,800	-	-	-	-
Income Subsidy	-	-	Max. of $10,000	Max. of $20,000	-	-
One-time Job Search Allowance	Max. of $1,250	-	-	-	-	-
One-time Relocation Allowance	Max. of $1,250	-	Max of $1,250	-	-	-
Reemployment, Training, or Support Services	-	-	-	-	Max. of $3,000	-

Training	$4,800	$5,000-$9,000	-	-	-	-
Average Health Coverage Tax Credit	$6,100	-	$8,100		-	-
Total	$32,700	$11,800-15,800	$19,400	$20,000	$3,000	$5,000

Sources: Authors' calculations based on data from DOL, Economic Policy Institute.

AGGREGATE COST ESTIMATES

The **aggregate** cost of wage insurance depends on several characteristics of the eligible population in addition to the program design choices discussed above:

- the number of eligible displaced workers;
- the wage loss of those who accept work at lower pay;
- and the duration of unemployment prior to reemployment (if there is a program start trigger, as described below).

Table 6 provides some of the key data drawn from the Department of Labor Displaced Worker Survey, which is necessary for constructing cost estimates. Among the key features of this table are the national unemployment rates; the numbers of workers who would be eligible for wage insurance; and the mean annual earnings loss of eligible workers who suffered a wage loss in accepting a new job. We restrict eligibility to workers permanently displaced from full-time jobs with 2 or more years tenure who enter full-time reemployment within 52 weeks at lower pay; alternative requirements would change the size and characteristics of the eligible pool and thus the cost estimates.

Table 6: REEMPLOYMENT RATE AND EARNINGS LOSS FOR DISPLACED* WORKERS
2000-2003
Thousands of Workers

	2000	**2001**	**2002**	**2003**
Unemployment Rate (%)	4.0	4.7	5.8	6.0
Total Displaced	2,667	3,465	3,615	5,050
Total Displaced from Full-Time Job**	1,191	1,985	1,903	2,318
Total Reemployed***	1,917	2,461	2,507	2,581

Total Full-Time Reemployed**	654	1,126	1,030	925
Total Full-Time Reemployed at Lower Wages****	258	514	452	375
Average Wage Loss ($)	$12,706	$17,463	$15,473	$14,792

*Workers are classified as displaced if they reported the reason for their job loss as one of the following: plant or company closed down or moved, insufficient work, position or shift abolished.
** Displaced from permanently lost, full-time jobs with at least 2-years tenure.
***Displaced within last 52 weeks.
**** Also restricted to those holding fewer than 4 jobs since reemployment.
Source: Authors'calculations based on BLS data.

For 2003, Table 4 further subdivides the data to compare the characteristics of displaced workers in overall manufacturing, overall services, and services potentially affected by offshoring. Interestingly, while displaced services workers earn roughly 10 percent more than displaced manufacturing workers on average, the absolute level of earnings losses are somewhat smaller, so that wage insurance need not be any more costly for services workers on average than for manufacturing workers (although on aggregate, the number of displaced is much larger in services than in manufacturing).

Table 7 below provides cost estimates for a wage insurance program under different assumptions about the duration of wage insurance payments (1 and 2 years); the replacement rate (30, 50, and 70 percent); and the annual cap of compensation payments ($10,000 and $20,000) over the period 2000-3. One central take-away from the table is that the estimated costs of the program have risen over time, especially since 2000. This is due to a combination of factors: higher unemployment and hence more displaced workers generally; a higher fraction of eligible workers who suffered a wage loss; and a higher average wage loss, which jumped especially between the 2001 and 2003 survey years. Accordingly, whereas in 2000, a wage insurance program with a two-year duration, 50 percent replacement rate, and a $10,000 annual cap would have cost $2.6 billion, by 2003, when the national unemployment rate was substantially higher, the cost for the same program would have cost $4.3 billion (in current dollars).

Table 7: COST OF GENERAL WAGE INSURANCE PROGRAM
2000-2003

$ Millions

One-Year Program

	2000			2001			2002			2003		
Total Eligible Thousands	258			514			452			375		
Replacement Rate	30%	50%	70%	30%	50%	70%	30%	50%	70%	30%	50%	70%
$10,000 Cap	864	1,249	1,529	1,984	2,606	3,033	1,776	2,469	2,907	1,381	1,803	2,104
$20,000 Cap	968	1,496	1,945	2,462	3,535	4,340	2,001	3,080	3,995	1,606	2,436	3,026

Two-Year Program

	2000			2001			2002			2003		
Total Eligible Thousands	503			772			966			827		
Replacement Rate	30%	50%	70%	30%	50%	70%	30%	50%	70%	30%	50%	70%
$10,000 Cap	1,854	2,592	3,112	2,848	3,854	4,562	3,760	5,074	5,939	3,158	4,272	5,011
$20,000 Cap	2,087	3,219	4,135	3,430	5,030	6,286	4,463	6,615	8,335	3,607	5,517	7,021

Source: Authors'calculations based on BLS data.

It is important to put these cost estimates in perspective. In 2003, for example, state and federal governments paid out $42.4 billion on unemployment insurance benefits. This figure is more than 10 times the estimated cost of a wage insurance program for that year (under the assumptions just laid out). Moreover, a substantial portion of the costs of a wage insurance program clearly would be tied to the economic cycle. The 2003-based cost estimate of $4.3 billion, for example, is not going to be representative of the cost of the program over, say, a 10-year period. Based on the data shown in Table 7, an annual average net cost of something like $3.5 billion for a two-year, 50 percent replacement rate, $10,000 annual cap program seems more realistic. And the costs of the program are substantially lower even in a year with high unemployment for more modest benefits. For 2003 alone, the costs of the program could range from a low of $1.4 billion for the most modest benefits (a one-year program with a 30 percent replacement rate and a $10,000 cap) to a high of $7.0 billion for the most generous package of benefits (a two-year program with a 70 percent replacement rate and a $20,000 annual cap).

Finally, providing a fairly generous wage insurance benefit as an option to TAA recipients would introduce cost savings relative to current spending on the TAA program. For example, providing two years of wage insurance at a 50 percent replacement rate with a $10,000 annual cap would have cost $335 million in 2003—39 percent less than actual spending on the TAA program.

Table 8: ESTIMATED WAGE INSURANCE COSTS FOR TAA POPULATION

$ Millions

	2002			**2003**		
	30%	50%	70%	30%	50%	70%
Two-Year Wage Insurance Program with $10,000-Per-Worker Cap	106	177	248	201	335	469
Total TAA Outlays		391			551	

Source: Author's Calculations and Department of Labor.

CROSS-OVER POLITICAL APPEAL AND FUNDING

A more comprehensive, incentive-based safety net for displaced worked encouraging rapid reemployment and on-the-job training should be good politics across the political spectrum. Indeed, wage insurance was one of the few recommendations on which the bipartisan members of the U.S. Trade Deficit Review Commission were able to agree in their 2000 report.[28]

For those who are supportive of government-provided active labor market policies generally, the program we have outlined should have natural appeal. Wage insurance would supplement trade adjustment programs and unemployment insurance, so that even more of many workers' unemployment losses are covered, while lowering unemployment durations and providing potential employers greater incentives to hire and train displaced workers.

[28] For earlier presentations of the idea. see Lori Kletzer and Robert E. Litan, "A Prescription for Worker Anxiety," *Brookings Policy Brief No. 73*, March 2001; Lael Brainard, *Protecting Losers: Optimal Diversification, Insurance, and Trade Policy*, NBER Working Paper No. 3773, 1991; Gary Burtless and Robert Litan *Globaphobia Revisited: Open Trade and Its Critics*, The Brookings Institution, 2001; and Lael Brainard and Robert E. Litan, "'Offshoring' Service Jobs: Bane or Boon and What to Do?", *Brookings Policy Brief No.132*, April 2004. See also Committee for Economic Development, *From Protest to Progress: Addressing Labor and Environmental Conditions through Freer Trade*, 2001.

For those who are sympathetic to government programs that extend aid only for individuals who demonstrate responsibility, our program also should be appealing. The wage insurance subsidy would only kick in *once a displaced worker has started a new job*. As a result, government aid helps those who actively seek reemployment.

Names are everything in politics, and the wage insurance plan we have suggested here is no exception. Fundamentally, what we are proposing is *insurance*, and thus charges for it really are *insurance premiums*, and *not taxes* (much as seniors paying for a portion of hospital insurance covered under "Part B" of Medicare are really paying a premium, albeit one that is subsidized). Indeed, the program could be implemented through an advanceable, refundable *wage insurance tax credit*.

FINANCING WAGE INSURANCE

Admittedly, a key sticking point for many who are opposed to any spending increase on principle and perhaps some who want limited resources directed elsewhere (such as more comprehensive health insurance), is how to finance the program. In part, we would expect some offsetting savings on unemployment and training programs from more rapid reemployment; the Canadian experience discussed above suggests savings on the order of $400 million or more. In addition, for those workers displaced by trade who choose wage insurance rather than TAA, the per worker cost is likely to be roughly one third less than the combined cost of the unemployment and training benefits of TAA, as shown in Table 5.

One relatively simple possible way to finance the uncovered costs of the program would be through a modest change in the current federal unemployment tax (FUTA) – with the incidence possibly split between employers and employees. Currently, employers pay a tax rate of 0.8 percent on workers' wages up to $7,000 per year to pay for the federal share of unemployment insurance. Under these conditions, the FUTA tax raises approximately $7 billion per year. If, hypothetically, an additional $3 billion were needed (which is a high estimate considering the potential for other program offsets), then Congress could raise the FUTA premium rate on the first $7,000 of earnings or raise the earnings ceiling above $7,000 or some combination of the two measures (a smaller increase in the tax rate and the earning ceiling). If the offsetting cost savings from wage insurance were more substantial

than $1 billion, it may be necessary to raise even less than $3 billion per year (averaged over a ten year period).

CONCLUSION

Using a conservative estimate of offsetting savings in other unemployment and training programs, the net cost of $3.5 billion per year amounts to an insurance premium of roughly $25 per worker per year. That is a small price to pay for shorter periods out of work and more efficient retooling for workers.

Wage insurance provides a critical tool to ease transitions in the face of accelerated job churning while preserving the benefits of an open and innovative economy. For the price of $25 per worker per year, the nation reaps economic benefits in the form of less job insecurity, more rapid returns to work, broader job searches, and more efficient reskilling through on-the-job training.

Wage insurance provides a critical tool to ease transitions in the face of accelerated job churning while preserving the benefits of an open and innovative economy. For $25 per worker per year, the nation reaps overall economic benefits in the form of more rapid returns to work, broader job searches, and more efficient reskilling through on the job training.

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