Wage insurance: A potentially bipartisan way to help the middle class

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With "middle class economics" as his latest agenda, President Obama has pivoted the national domestic policy agenda away from six years of debate about stimulus and then deficit reduction to ensuring that the fruits of economic growth are broadly shared. Even a number of apparent Republican Presidential hopefuls – Jeb Bush, Marco Rubio and Rand Paul – and others, in recent speeches or writings, have agreed with this objective, implicitly if not explicitly.

The big debate going forward will be over means and not ends. The President would redistribute incomes through changes in the income tax code, while upgrading the skills of both young people and older workers seeking career improvement by making two years of community college free. Republicans have not yet settled on a single counter-approach – how could they be expected to, there are many of them in Congress and they don't control the Executive branch – but they clearly will oppose redistribution. Instead, Republicans are inclined to favor an "opportunity" agenda that is likely to contain multiple ideas: more school choice, consolidating multiple federal anti-poverty programs into single funding streams or block grants to the states, tax reform that lowers individual and corporate tax rates, and possibly some form of wage subsidies.

The odds are long that Obama, his party, and multiple Republican factions will be able to agree on some form of compromise (although the word itself is a non-starter for many Congressional members in both parties) on a middle class economic agenda in the remaining two years of the President's second term. But at least the debate will have been started and some core ideas from both parties settled to give voters in 2016 a clear choice on which approaches and policies they prefer.

In that spirit, and with no illusions that it will be adopted in the next two years, I reprise here an idea primarily for addressing middle class economic anxieties that I have spent much of my professional life as an economist promoting, along with others inside and outside Brookings: Wage insurance. I do not advocate it as a silver bullet that will magically ensure continued rapid wage growth of middle class workers and their families in the future, but as one important element that can help advance that objective, along with improvements in the delivery and financing of education of current and future workers that better equips with them with skills they will need to realize continued income gains.

Since the Depression, the United States has had a federal unemployment insurance program administered by the states that provides limited financial protection to help tide unemployed workers over until they find a new job. Unless they are extended during severe recessions like the last one, UI payments last for six months.

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Many workers, however, can suffer a permanent loss in lifetime income if the new job they eventually get pays less than the one they had. In effect, these workers fall a step or two down the economic ladder and may never fully climb back to their place in the workforce income structure, or if they do, it can take many years to do so. The cumulative income losses from job downshifting can easily swamp the temporary loss of income while they are without a job.

The economic losses from downshifting can be especially acute and widespread during severe recessions – as in the Great Recession of 2008–09 – or for workers left behind as technological change marches on. In both cases, laid-off workers can have an especially difficult time finding new employment paying anything close to the salaries they had earned before. This means longer spells of unemployment – the long-term employed peaked at over 40 percent of all those without jobs during the Great Recession – during which workers lose skills and motivation,

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both of which aggravate the drop in earnings they are likely to be compelled to accept when they do find another job.

Wage insurance would address these problems. The program would be constructed to provide laid-off workers with some job experience at a company (say, a minimum of one year, to prevent workers from excessively changing jobs in order to get repeated wage insurance payments) with monthly or quarterly earnings supplements, compensating unemployed workers for a portion of their lost wages, up to some limit, when they do find new jobs.

For example, assume the program insured eligible workers for one-half of their earnings loss up to $200 per week (approximately $10,000 per year). A laid off worker who had previously worked for $800 week who lands a new job paying only $400 would receive a regular insurance check for $200 – lifting his/her income to $600 a week for as long as the insurance payments are made.

A key feature of the wage insurance program I and others (like Harvard's Robert Lawrence, my current Brookings colleagues Martin Baily and Gary Burtless, and our former colleague and current Federal Reserve Governor Lael Brainard) have supported would only provide payments once an unemployed worker obtains a job and then for two years from the date of unemployment. These features provide strong incentives for laid off workers to search aggressively for a new job, and if necessary, also to be willing to take a short-term pay cut as the price for being trained in perhaps new skills at a new job. Indeed, economic research has established that, in the absence of a major career change, the best way to get new training is on the job rather than through some government training program, where job prospects are highly uncertain after one finishes.

In effect, wage insurance acts as a subsidy for employers to help pay the cost of training new hires, while cushioning the economic pain suffered when unemployed workers take new jobs paying less than what they were earning before their layoffs.

Prior estimates for years in which the economy was reasonably close to full employment suggest that the annual net cost of wage insurance, including the UI payments it would save, would cost several billion dollars a year. Admittedly, the annual cost temporarily would be several times higher in years of severe recession, such as the one just experienced, but even at that level represents a small fraction of annual UI payments, and a tiny fraction of the budgetary cost 2009-10 stimulus package, or anything like it that would be expected in any future large economic downturn. The modest cost aside, at a macroeconomic level, wage insurance would augment the automatic stabilizing feature of the unemployment insurance program. It could be financed annually with a small addition to the federal unemployment insurance tax paid by employers.

To be sure, because wage insurance payments would be tied to the level of income loss, the program would not offer much protection to workers who are steadily or erratically employed in low-wage jobs, although some low wage workers could benefit modestly. For that reason, education and training programs are necessary for giving these workers the skills they need to land higher paying jobs, which if they lose, would entitle them under a wage insurance system to more protection when looking for other such jobs.

In addition, the effectiveness of wage insurance can be blunted during recessions, such as the most recent one, when demand for labor drops sharply and there are few jobs to fill. But even during much of this weak recovery, there have been several

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million vacancies, meaning that employers cannot find suitable workers to fill them – known as a skills mismatch. Given the reluctance of firms these days to spend a lot on worker retraining for the fear that newly trained employees could later leave and take their training with them, it is understandable why firms with vacancies, even during downturns, have so far been willing to wait only for the perfectly trained applicants to come in the door.

The availability of wage insurance would change this dynamic, even in weak labor markets. That is because the insurance payments, while also helping to protect unemployed workers from downside risk when taking a new lower paying job, for the very same reason make them more willing to accept such a job rather than continue to collect unemployment insurance or dropping out of the labor force altogether (as many have done). If more workers had the insurance payments in hand, they would be willing to accept new jobs at lower pay if firms would train them. That lower pay effectively acts like a training subsidy to firms that provide training to workers to fill those vacancies, and thus increases their incentives to take on new workers. Employees who accept temporarily lower pay for new kinds of jobs, in turn, get themselves back more quickly on new career ladders, which improves their lifetime earnings prospects while alleviating the anxieties of continued unemployment.

In addition, to the extent that wage insurance encourages workers to remain in the labor force, that improves the accuracy of the unemployment rate in indicating the overall tightness or slack in the labor market. In the recent recession, with so many discouraged workers leaving the labor force, the unemployment rate has been deceptively low. An unemployment rate measure that is more indicative of the true weakness of the labor force will allow the Federal Reserve to maintain expansionary monetary policy for a longer period, leading to more total employment than would otherwise be the case.

Wage insurance has features that, in principle, should make it politically attractive to both parties, perhaps more so in the wake of the Great Recession. It is an inexpensive, targeted and efficient way to address middle class voters' anxiety about falling down the economic ladder. Democrats should be attracted to the safety net feature of the idea, plus the career enhancing and job stimulus effects of wage insurance just outlined. For their part, Republicans should like the fact that the program provides strong incentives for unemployed workers to aggressively look for new work, since the sooner they accept a new job, even if it pays less, the more they can collect from the program (and the more they can save federal and state governments in reduced UI payments).

If wage insurance is so sensible substantively and politically, as I believe it is, then why haven't leaders of either party embraced the idea, beyond the highly restricted pilot program Congress instituted only for a few hundred workers displaced by imports in the early 2000s? President Obama, for example, appointed Vice President Biden to lead a task force on worker training programs, which has recommended more funding for matching community colleges with businesses in need of trained workers, and for apprenticeship programs to enable workers to gain more training on the job. But the task force said nothing about wage insurance, which also was absent from the President's State of the Union address this year. Nor have Congressional members from either party so far evidenced any interest in wage insurance.

Several reasons help explain the lack of political interest in the idea so far. Some Democrats may fear that the program may induce laid off workers to accept lower wage jobs too quickly, even though getting back into work is best for individuals' sense of self-worth. Given their concerns about budget deficits, many Republicans may not have been ready to embrace any safety net program.

The Great Recession, in my view, has changed the calculus for both parties. Members of both parties now are interested in helping the middle class. Many Democrats should realize that with continuing technological change, many laid off workers have no chance of returning to their former jobs, or to new jobs paying what their previous ones did. Wage insurance helps address that problem, by getting workers back on a new earnings path quickly, while cushioning the pain from having to take a lower paying job.

Many Republicans, though still committed to deficit reduction, must realize that addressing concerns of the middle class will cost money, whether through tax cuts or better safety nets. The particular advantage of wage insurance for Republicans is that it is targeted and inexpensive, and consistent with their party's emphasis on self-improvement.

In short, the time is right for a bipartisan consensus on wage insurance, if not in the balance of the Obama administration, then as a top priority for the new President and Congress after the 2106 election.