The Brookings Institution
Washington, DC

Policy Brief

No. 73
March 2001

Kletzer and Litan

# A Prescription to Relieve Worker Anxiety

With the sharp slowing of the economy, worker anxiety is back in the news. But even during healthy economic times such as the late 1990s, workers feared layoffs and general job instability. The failure of Congress to approve fast track trade negotiating authority in 1997 strongly suggests that no American president will be successful in persuading the Congress and the American people to accept further trade liberalization until additional measures, aimed specifically at easing the pain of worker dislocations and encouraging rapid reemployment, are embraced by federal policymakers. In this brief, we outline and present cost estimates for two such proposals: wage insurance for qualifying displaced workers upon reemployment, and subsidies for health insurance for qualifying unemployed displaced workers. Both programs would provide benefits to full-time workers who have been dislocated, for any reason, from jobs they have held for at least two years.

Americans have been bombarded by media coverage of the slowing U.S. economy. During the last three months of 2000, the economy generated an average of 46,000 new jobs per month, a pace much slower than the average monthly gain of 187,000 jobs for the first nine months of 2000 (and 229,000 new jobs per month average for all of 1999). The unemployment rate rose to 4.2 percent for January 2001 from 4.0 percent for December 2000, and with layoffs expected to increase in the coming months, the unemployment rate may move beyond 4.5 percent, and perhaps as high as 5 percent later this year.

In fact, many workers have been anxious about losing their jobs even during the high points of the record expansion of the 1990s, and for good reason. Despite the low overall level of unemployment throughout this period, job loss and turnover in the labor markets have been prevalent. For many workers, job loss imposes substantial costs, not only during spells of unemployment but also afterwards, if they are forced to take a cut in pay in their new jobs.

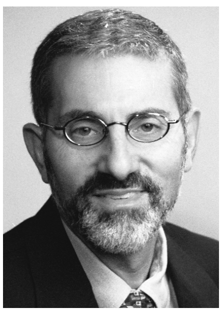
The relatively high level of job turnover in the U.S. economy—among the highest in the world—has its benefits. Flexible labor markets facilitate the rapid redeployment of labor to sectors, such as high-tech, where it is highly valued and much in demand. Young workers benefit from easy turnover, as they gain experience and skills and find better matches with employers.

But labor market churning has its downsides as well. Widespread job loss leads to feelings of uncertainty and insecurity among jobholders, especially older workers who typically suffer larger income losses when

Lori G. Kletzer

Lori G. Kletzer is a visiting fellow at the Institute for International Economics and an associate professor of Economics at the University of California, Santa Cruz.

Robert E. Litan



Robert E. Litan is vice president and director of the Economic Studies Program at the Brookings Institution, where he also holds the Cabot Family Chair in Economics.

# Wage and Health Insurance

displaced. Nervous workers have less reason to show loyalty to firms and morale suffers when workers fear they might be readily laid off. For similar reasons, many Americans are hesitant about government efforts to further reduce trade barriers, which they believe places American jobs—and wages—at risk.

Continued worker anxiety clearly was one of the reasons why, even in the midst of a record-setting economic expansion, the Clinton administration failed in its 1997 and 1998 efforts to convince Congress to give the president "fast-track" trade negotiating authority. Among other factors, worker anxiety fueled the protests against the World Trade Organization in Seattle in 1999 and against the International Monetary Fund and the World Bank in Washington, D.C., and Prague in 2000. Job insecurity helps explain the political resonance of organized labor's insistence that any new trade agreements with less developed countries contain certain guaranteed or enhanced "labor standards." More broadly, fears of job loss account for surveys showing weak public commitment to further liberalization of barriers to foreign trade and investment. [1]

The Bush administration has signaled that it wants to reach new trade agreements, in large part because other nations will form trade blocks among themselves if the United States does not push the liberalization agenda. But the current economic slowdown will make it more difficult than ever to achieve success on the trade front.

Looser monetary policy by the Federal Reserve over the next few months should dampen the severity of the slowdown and thus reduce the nervousness among workers. But as the continued worker anxiety of the 1990s has demonstrated, in an increasingly global economy good times are not enough to ease worker concerns that competition from abroad threatens their jobs or their wages. Economic argument and evidence is not likely to reduce worker concerns either, despite the widespread conclusion that trade ranks behind technological change and immigration as a source of job loss and declining real wages of less-educated workers. Without strong public support, it is unlikely that sufficient political support (or domestic consensus) can be built for restarting dialogue on trade liberalization and open markets, which is why federal policymakers should aim to implement programs that address worker anxiety and encourage rapid reemployment.

Accordingly, we propose here two benefit programs that would do precisely that: 1) wage insurance and 2) subsidies for health insurance for qualifying displaced workers upon reemployment. At recent levels of unemployment, the total annual cost of these two programs is projected at roughly $3 billion to $3.5 billion, even if the unemployment rate should rise to the 5 percent range. In our view, the economic and political benefits that these

# for Displaced Workers

programs would promise are well above the costs, and such costs are readily affordable, given sizeable projected federal surpluses.

## Even In Good Times, Workers Have Had Reasons To Be Anxious

Data from the Mass Layoff Statistics (MLS) program, a joint project of the Bureau of Labor Statistics (BLS) and state employment security agencies, reveal a considerable amount of job loss throughout the economy, even during this record expansion. The MLS program counts as a mass layoff a job loss action associated with 50 or more worker claims against an establishment's unemployment insurance account during a five-week period.

In 1999, 1.15 million workers lost their jobs through mass layoffs, down only a fraction from the 1.18 million total in 1996. Given the drop in the unemployment rate from a 5.4 percent annual average for 1996 to 4.2 percent for 1999, the level of mass layoffs remains stubbornly high. The same is true for permanent layoffs (excluding the end of seasonal or temporary jobs), which, according to Rosemary Hyson and James Spletzer, researchers at BLS, numbered about one-half million in both 1999 and 1996. The fact that job turnover remains high despite the low national unemployment rate gives many workers ample reason to be anxious about job security despite the strong economy.

Not surprisingly, less-educated workers have faced the highest risk of losing a job, although their rate of job loss (12 percent) in the hot job market of the late 1990s was not much different from the late 1980s, also a period of healthy demand for labor. However, as Henry Farber of Princeton University has shown, job loss rates among workers with higher levels of education increased in the early 1990s and by 1997-99 stood at nearly 7 percent, as compared with 5.4 percent for 1987-89.

Losing a job is a traumatic experience. Workers not only lose income when they are unemployed, but many often suffer a drop in their earnings after finding new jobs. Older workers—who tend to be less flexible adapting to new production techniques or who lack the educational background to transfer to well-paid service economy jobs—bear the greatest losses. According to the February 1998 Displaced Worker Survey, workers aged 45 to 64 years experienced earnings losses averaging 12 percent. In contrast, Steve Hipple of BLS has found that workers aged 25 to 34 years actually *increased* their earnings, on average, by 5.5 percent after losing a job (the averages were calculated for workers with three or more years of tenure when they were displaced from a full-time job during 1995-1996 and re-employed in a full-time job in February 1998).

Trade liberalization is often a focal point for anxiety about job insecurity, and job loss is costly for workers displaced from manufacturing industries where import competition is strong; on average, weekly earnings on the new job are about 17 percent lower than on the old job. These earnings losses are large, but it is critically important to note that they are not much different from the average earnings losses for all displaced manufacturing workers (16 percent).

Job displacement can result from a number of factors: technological change, downsizing, restructuring, changes in consumer demand, changes in public policy (trade liberalization and environmental regulation are two examples). Yet one of the most important recent findings is that for most displaced manufacturing workers, what matters is the kind of job lost and the kind of job regained, not why the job was lost. If workers and consequences are alike among the various causes of job loss, including increasing foreign competition, technological change, and downsizing, then policymakers need to consider adjustment policy for all displaced workers, not just those who are displaced by trade.

## Compensating Unemployed Workers

Aside from their own assets and other family members' earnings, unemployed workers currently have one primary source of income to tide them over until they find a new job: unemployment insurance (UI). Unemployment insurance, introduced in 1935 as part of the Social Security Act, cushions the economic losses suffered by workers who are laid off through no fault of their own. The significant jump in compensation payments during a recession also acts as an automatic fiscal stabilizer, helping to sustain aggregate consumption—and the overall economy—when joblessness increases.

Since 1974, UI has been supplemented for eligible workers for whom it can be documented that increasing imports have contributed to their displacement. Under the most recent version of the Trade Adjustment Assistance (TAA) Act, qualified workers may gain an additional 52 weeks of UI payments, provided they are enrolled in an approved training program. A similar program, the North American Free Trade Agreement Transitional Adjustment Assistance (NAFTA-TAA) program, was created in 1993. For eligibility, workers must prove that they lost their job because of increased imports from, or a shift in production to, either Canada or Mexico. The UI, TAA, and NAFTA-TAA programs are administered by state unemployment offices.

The federal government makes a modest contribution to fund UI (states bear the rest of the cost) and pays all of the expenses associated with TAA and NAFTA-TAA. In the last half of the 1990s—as the unemployment rate drifted down from about 5.5 percent to roughly 4 percent—total UI benefit payments have been generally stable at about $20 billion per year. TAA and NAFTA-TAA payments have been far lower, generally less than $300 million annually.

Not everyone who is counted as unemployed qualifies for UI: only those who are laid off or otherwise involuntarily released from their job can receive unemployment compensation. These workers account for only about 45 percent of the unemployed. The rest of the people whom the Labor Department classifies as unemployed include those who are between jobs voluntarily (in recent years about 10-15 percent of the total) and those just entering or reentering the labor market as new job seekers (40-45 percent of the unemployed). The share of workers who qualify for TAA and NAFTA-TAA is far lower.

The existing safety net for replacing the lost income of displaced workers has a number of holes, which aggravate workers' anxiety about the prospect of losing their jobs. Perhaps most important, the payments under UI are limited, generally replacing a little less than 50 percent of the average worker's previous salary. In 1999, the average weekly earnings of a production worker in wage and salary employment was $457, while the average weekly unemployment check was $212. Most eligible workers receive payments for just six months. Fortunately, this eligibility period is longer than the average spell of unemployment, which has been between three and four months over the past five years. However, the compensation payments do not help workers who suffer a loss in earnings after they take a new job. Moreover, although all laid-off workers now have the right to purchase unsubsidized health insurance from their former employer if it was offered when they were employed, many jobless workers do not have the money to take advantage of this guarantee.

Workers who receive additional compensation under TAA must be enrolled in an approved training program. The evidence that these training programs are useful is weak, at best, and understandably so. Workers have no guarantees of employment when they finish the training programs. For this reason, there is broad consensus that the best training is delivered on the job, or if workers are already at a job, then in supplemental programs that workers help pay for themselves and choose to attend at night or during other off-hours.

## A New Safety Net for Displaced Workers

There is a better way to provide a safety net to displaced workers—regardless of the reason for their job loss—and, at the same time, encourage workers to accept new employment offers more rapidly and to gain the training they need at their new jobs. This strengthened safety net should help reduce workers' anxieties about losing their current jobs, and thus diminish worker opposition to further trade liberalization that promises lower prices and broader product choice that benefits society as a whole. Our proposal has two components: 1) an offer of "wage insurance" upon reemployment, and subsidies for medical insurance, in lieu of the current TAA (whose benefits Congress may nonetheless be willing to offer as an option to the compensation we have suggested). In either case, workers would still be eligible to collect unemployment insurance if they otherwise qualify.

To qualify for our proposed supplemental wage insurance benefit, workers need only document that they have been "displaced" according to criteria similar to the operational definition of displacement used by BLS in its Displaced Worker Surveys (relocation or closing of a plant or company, elimination of a position or shift, insufficient work); that they had served at their previous job for a minimum period of time—we suggest two years; and that they have suffered an earnings loss (from old job to new job) that can be documented through state unemployment insurance offices and employer quarterly earnings withholding reports. A broader population would be eligible for our proposed health insurance subsidy: all full-time displaced workers would receive the subsidy, for up to 6 months, or until they found a new job (whichever is earlier). To prevent job churning, workers could be limited to receiving the subsidy no more frequently than once during any three- or four-year period.

Wage insurance would work as follows: eligible workers would receive some fraction of their wage loss—which could vary by age and tenure of the worker—for up to two years following the initial date of job loss, but would begin to paid *only when workers found a new job*. The payments would be administered through state UI. In the cost estimates we show here, we have assumed that the average

## Table 1: Displaced Workers in the Late 1990s

| | 1997 | 1999 |
|---|---|---|
| Unemployment Rate, average for the year | 4.9% | 4.2% |
| Displaced workers | 8,521,883 | 8,005,659 |
| Workers displaced from full-time jobs | 6,416,460 | 6,280,796 |
| Reemployed displaced workers | 5,212,776 | 4,958,590 |
| Reemployed displaced workers (full-time) | 3,694,375 | 3,647,698 |
| Displaced workers eligible for wage insurance | 797,240 | 651,391 |
| Workers ineligible for wage insurance | | |
| Reemployed but less than 2 years job tenure on old job | 1,383,465 | 1,509,891 |
| New job earnings greater than or equal to old job earnings | 1,327,798 | 1,308,893 |
| Other[1] | 185,873 | 177,523 |
| Mean annual earnings loss of qualified participants[2] | $8,862 | $7,513 |
| Mean annual earnings on old job of qualified participants | $39,526 | $42,334 |

1. Other for 1997: Respondents with four or more jobs since displacement or no response to number of jobs held: 111,179. No reported earnings, was not working in last year: 12,568. New job after end of 1997: 62,126. Other for 1998: Respondents with four or more jobs since displacement or no response to number of jobs held: 102,455. No reported earnings, was not working in last year: 0. New job after end of 1999: 75,068. 2. Due to lower earnings on new job. This estimate does not include income loss due to unemployment.
*Source: Authors' calculations from 1998 and 2000 Displaced Worker Surveys, supplements to the February Current Population Survey. Estimates are in current year dollars.*

payment is 50 percent of the earnings loss, and is provided only for workers whose previous and new jobs were full-time (benefits could be extended to workers reemployed in part-time jobs, with payments adjusted based on hours worked). For example, a displaced worker who once earned $40,000 and found a new job paying just $30,000 would receive $5,000 (in quarterly payments) until two years after the initial layoff. We also recommend that the annual payments should be capped, perhaps at something like $10,000. Our plan would be available to all qualifying displaced workers, not just those displaced by trade.

Table 1 provides estimates of the numbers of reemployed displaced workers who would have qualified for both the wage insurance and health insurance benefits under our proposed program, during both 1997 and 1999, based on the Displaced Worker Surveys for those years. The table shows that of displaced workers reemployed full-time, approximately 20 percent would have had at least two years' tenure on their previous job and suffered a wage loss in taking new employment (many more workers actually obtained a job that paid more than the previous job).

Table 2 reports the estimated budgetary cost for compensating the qualified workers estimated in Table 1, again for both 1997 and 1999. Assuming a 50 percent replacement and subsidy rate, the table indicates that our wage insurance and health insurance program would have cost about $2.9 billion in 1999, when the national unemployment rate averaged 4.2 percent. The total cost of the two programs would have been $3.6 billion in 1997 when the national unemployment rate was 4.9 percent. Total costs would increase by about $200 million in each year if workers reemployed part-time continue to receive health insurance benefits.

Given the recent and expected slowdown in overall economic activity, this last number is close to the possible average for 2001, assuming that the unemployment rate actually averages the 1997 level, which now seems a bit high (technically, the current dollar cost would be approximately 10 percent higher than 1997 due to inflation). The health insurance program would be considerably more expensive if extended to all workers eligible for UI rather than just "displaced" workers.

## Table 2: Displaced Worker Wage Insurance Program, Annual Cost Estimates

| | | Amount of benefit (in millions of current dollars) | | |
|---|---|---|---|---|
| | | 30% | 50% | 70% |
| **1997** | Wage Insurance Benefit (capped at $10,000) | $2,037 | $2,962 | $3,634 |
| | Wage Insurance Benefit (capped at $20,000) | 2,221 | 3,490 | 4,616 |
| | Wage Insurance Benefit (not capped) | 2,276 | 3,794 | 5,311 |
| | Health Insurance Benefit[1] | 476 | 794 | 1,112 |
| **1999** | Wage Insurance Benefit (capped at $10,000) | 1,528 | 2,256 | 2,812 |
| | Wage Insurance Benefit (capped at $20,000) | 1,672 | 2,631 | 3,466 |
| | Wage Insurance Benefit (not capped) | 1,762 | 2,937 | 4,111 |
| | Health Insurance Benefit[1] | 445 | 742 | 1,039 |

1. Workers who are displaced from full-time jobs, regardless of tenure on old job, receive health benefits equal to a percentage of the average health premium paid by employers for a six-month period following displacement. If workers are reemployed within the six-month period, the health benefit ends on their date of reemployment.
*Source: Authors' calculations from 1998 and 2000 Displaced Worker Surveys, supplements to the February Current Population Survey. Estimates are in current year dollars.*

We believe several arguments support the kind of extended safety net we have outlined. One is that the program addresses real needs that many workers have, whether they are currently displaced or fear future displacement. Second, the structure of the program—which triggers the benefits only when workers obtain new employment—contains incentives for workers to accept new jobs more quickly, and in a broader scope, than they do now. Third, the program in effect subsidizes retraining on the job, where it is likely to be far more useful than in a training program where reemployment prospects are uncertain.

Finally, reducing worker anxiety should reduce worker opposition to trade liberalization and globalization more broadly. There is ample evidence that opinions become more favorable toward trade liberalization when it is linked to worker adjustment assistance. [2] Our view about worker assistance is also reflected in the findings the Trade Deficit Review Commission reported in late 2000. The Commission could not agree on anything about the trade deficit—including what causes it and how to remedy it—but did agree on exploring a wage insurance program for displaced workers as a way of mitigating opposition to trade liberalization.

Objections to our suggested programs can be easily met. The total cost, less than $4 billion, might have been a major obstacle when federal deficits were high and growing but is not a problem now, and in any event would be small in relation to the more than $20 billion that is now spent on unemployment insurance, as well as to the tax cuts that are being contemplated for many upper income Americans. Furthermore, these costs are a tiny fraction of the $500 billion that one recent study estimates the U.S. would gain from global free trade (all post-Uruguay Round trade barriers completely removed). [3]

Some economists have suggested that wage insurance in particular creates a "moral hazard" for employers, encouraging them to pay less because they know that workers will be partially compensated by the federal government. We do not believe this effect is likely to be significant given the large numbers of new entrants into the labor force who do not receive these

This Policy Brief is being simultaneously published by the Brookings Institution and the Institute for International Economics.

The authors thank Samara Potter for her invaluable research assistance and C. Fred Bergsten, Gary Burtless, Catherine Mann, Dave Richardson, and Charles Schultze for their comments on drafts of this Policy Brief.

# The Brookings Institution

1775 Massachusetts Ave. N.W.
Washington, DC 20036




benefits, coupled with unemployed workers who do not qualify for the program. The United States has a large labor market where wages are set by overall supply and demand.

## Government Support for Workers

Trade Adjustment Assistance, up for renewal or extension this year, can no longer be the centerpiece of displaced worker adjustment policy. Critics of TAA can be found across the political spectrum, because the program does not work. It fails to address the most critical component of worker costs: earnings losses after reemployment. It also works as a disincentive to rapid reemployment. Our proposal focuses on reemployment while acknowledging and helping to mitigate the losses in earnings that workers experience when they lose a job for reasons unrelated to their own performance. Wage insurance in particular should encourage workers to be reemployed rapidly while improving their access to on-the-job training.

Free trade and open markets play important roles in facilitating economic growth while restraining inflation. But open engagement with the world does not help everyone. Government must offer real help to workers who are hurt in the process. Political leaders should not be surprised to find that public support for further trade liberalization is weak until that help arrives.

1,2. Scheve, Kenneth and Matthew Slaughter, *Globalization and the Perceptions of American Workers*, Institute for International Economics, March 2001.
3. Brown, Drusilla K., Alan V. Deardorff, and Robert M. Stern, "CGE Modeling and Analysis of Multilateral and Regional Negotiating Options," in R.M. Stern, ed., Issues and Options for U.S.-Japan Trade Policies. Ann Arbor: University of Michigan Press, forthcoming 2001.

### Recent Policy Briefs

*Iraq: Time for a Modified Approach*
Meghan L. O'Sullivan (February 2001)

*Defending America*
James M. Lindsay and Michael E. O'Hanlon (February 2001)

### Related Books/Materials


Rosemary Hyson and James R. Spletzer, "Large-scale Layoffs, Employment Dynamics and Firm Survival," Bureau of Labor Statistics working paper (January 2001)

Lori G. Kletzer, "What are the costs of job loss from import-competing industries?" Institute for International Economics (2001)

Steven Kull, "Americans on Globalization: A Study of U.S. Public Attitudes," Program on International Policy Attitudes (March 2000)

U.S. General Accounting Office. "Trade Adjustment Assistance: Trends, Outcomes, and Management Issues in Dislocated Worker Programs," GAO-01-59 (October 2000)

James R. Storey, "Trade Adjustment Insurance for Workers: Proposals for Renewal and Reform," Congressional Research Service (1999)

Steve Hipple, "Worker Displacement in the Mid-1990s," *Monthly Labor Review* (July 1999)

*Globaphobia: Confronting Fears about Open Trade*
Gary Burtless, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro (1998)

Louis Jacobson, Robert LaLonde, and Daniel Sullivan, "The Costs of Worker Dislocation," W.E. Upjohn Institute for Employment Research (1993)