The Brookings Institution
POLICY BRIEF
July 2005
Policy Brief #143

Want to Read More?

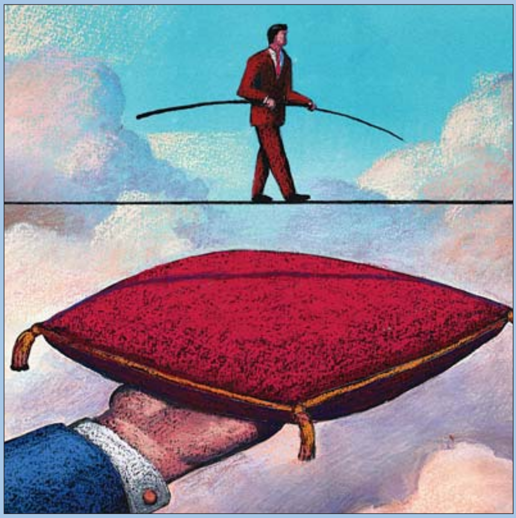
- *Offshoring White-Collar Work—The Issues and Implications*
  Lael Brainard and Susan M. Collins, eds.
  The Brookings Trade Forum (Forthcoming)
- *"'Offshoring' Service Jobs: Bane or Boon and What to Do?"*
  Lael Brainard and Robert E. Litan
  Brookings Policy Brief No.132 (April 2004)
- *Globaphobia Revisited: Open Trade and Its Critics*
  Gary Burtless and Robert E. Litan (2001)
- *"A Prescription for Worker Anxiety"*
  Lori Kletzer and Robert E. Litan
  Brookings Policy Brief No. 73 (March 2001)
- *Testing a Re-employment Incentive for Displaced Workers*
  Harold Bloom, Saul Schwartz, Susanna Lui-Gurr and Suk-Won Lee (1999)
- *Protecting Losers: Optimal Diversification, Insurance, and Trade Policy*
  Lael Brainard
  NBER Working Paper No. 3773 (1991)

GLOBAL ECONOMY & DEVELOPMENT CENTER
AT THE BROOKINGS INSTITUTION

1775 Massachusetts Ave. NW
Washington, DC 20036

Insuring America's Workers in a New Era of Offshoring

LAEL BRAINARD, ROBERT E. LITAN, AND NICHOLAS WARREN



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.

For a detailed analysis of our proposal, see Lael Brainard, Bob Litan, and Nicholas Warren, "A Fairer Deal for America's Workers in a New Era of Offshoring" in Lael Brainard and Susan M. Collins (editors): Offshoring White-Collar Work—The Issues and Implications, *Brookings Trade Forum, Forthcoming.*

White-collar offshoring burst into public consciousness early last year in the middle of a peculiarly unbalanced recovery, in which the share of national income going to workers and the rate of job creation were both unusually low. Coming on top of accelerated job shedding in manufacturing and the bursting of the information technology bubble, this new wave of offshoring expanded yet again the group of U.S. workers facing fundamental insecurity about future earnings.

Despite the fact that the U.S. labor market ranks second to none when it comes to job turnover, the nation's safety net for easing job transitions remains one of the weakest among the wealthy economies. The main federally mandated unemployment insurance (UI) program contains so many restrictions that today only about 40 percent of all jobless workers receive benefits. Meanwhile, workers have long found it difficult, time-consuming, and expensive to prove that they are entitled to extended unemployment benefits under the nation's Trade Adjustment Assistance (TAA) program. Despite important reforms in 2002, TAA has helped fewer than 75,000 new workers per year, while denying more than 40 percent of all employers' petitions (see Table 2). Further, there are concerns about the effectiveness of TAA training, since it is not directly connected to a job opening and, therefore, may never be put to use. And remarkably, the Department of Labor has interpreted the TAA statute as excluding the growing number of services workers displaced by trade.

With workers' firm-specific skills losing value at an accelerating pace in the face of offshoring and technological change, the time has come for the federal government to adopt a new and better insurance program—one that insures against wage loss, not just unemployment, for permanently displaced workers. Wage insurance would encourage workers to broaden their employment search and go back to work more quickly, while defraying the cost to employers of hiring and providing on-the-job training to new employees from different sectors. With wage insurance, the nation's economy as a whole would benefit from shorter spells of joblessness and more efficient reskilling for workers.

Table 1
Displaced Workers:
Prior Earnings, Earnings Losses, and Unemployment Durations, 2001–2003 Averages

	Full-Time Workers Displaced	Average Earnings on Lost Job	Change in Earnings in New Job	Average Weeks without Work
Trade Displaced (TAA)*	71,000	$32,505	-21%	80**
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

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.

Lael Brainard is vice president and director of the Global Economy and Development Center and holder of the New Century Chair in International Trade and Economics at the Brookings Institution.

Robert E. Litan is senior fellow at the Brookings Institution and also vice president for research and policy at the Kauffman Foundation.

Nicholas Warren is a senior research analyst at the Brookings Institution.

ASSESSING EXISTING UNEMPLOYMENT AND TRADE ADJUSTMENT PROGRAMS

America's safety net is miserly in comparison with those of almost every other advanced economy. Not only do U.S. unemployment benefits have a short duration, but America's heavy reliance on an employer-based system of insurance means that displaced workers face the prospect of losing health and retirement benefits along with income. The consequences of job loss are particularly damaging in import-competing industries, where displaced workers face longer spells of unemployment and greater permanent wage declines than do workers in other industries.

President John F. Kennedy established the TAA program in 1962 to compensate workers who suffer job loss as a result of trade liberalization that otherwise brings gains to the economy overall. In 2002 Congress overhauled and expanded TAA, adding a health care tax credit, doubling the training budget, and substantially raising budget outlays for income support. But the TAA program continues to disappoint.

Participation has remained surprisingly low, thanks in part to confusing Department of Labor interpretations and practices that ultimately deny benefits to roughly three-quarters of workers who are certified as eligible for them. As shown in Table 2, nearly half of all petitions for Trade Adjustment Assistance were denied in 2003, and less than one-quarter of workers certified eligible received income support.

Moreover, funding for training under TAA remains woefully inadequate. Partly as a result, the share of workers who do not receive training benefits rose by one-third in 2003 and, as shown in Table 2, now stands at two-thirds of newly certified workers.

Despite its laudable goals, the TAA program has repeatedly failed to meet expectations. Between 2001 and 2004, an average of only 64 percent of participants found jobs while they participated in TAA. And the wage loss for those who found new work rose sharply, from 13 percent in 2001 to 26 percent in 2004.

Finally, during the 2002 debate over TAA reform, Congress rejected a strong push by some farsighted members to expand coverage explicitly to services workers. And the Department of Labor hewed to a restrictive interpretation of the statutory eligibility criteria in rejecting a petition for coverage by information technology workers—a decision now being contested in the courts. With the rapid spread of globalization through the hitherto largely nontradeable services sector, these decisions effectively shrank the nation's safety net so that it covers an ever smaller share of at-risk workers.

WAGE INSURANCE IN THEORY AND PRACTICE

A chief goal of wage insurance is to speed the reemployment of workers who have been permanently displaced. Wage insurance is most likely to have overall positive economic benefits if it targets workers whose earnings would otherwise fall dramatically as forces outside their control devalue their firm-specific skills. These workers, hoping to regain their former

"Despite the fact that the U.S. labor market ranks second to none when it comes to job turnover, the nation's safety net for easing job transitions remains one of the weakest among the wealthy economies."

Table 2
TAA Certification, Denials, and Enrollment, 2000–2004

	2000	2001	2002	2003	2004
Petitions	1,382	2,353	2,404	3,564	2,918
Percent Petitions Certified	61%	44%	69%	53%	59%
Number of Workers Certified	98,007	139,587	225,072	197,264	147,956
Number of Workers Denied	53,433	59,067	74,760	91,585	55,295
Percent of Newly Certified Receiving Income Support	34%	23%	16%	22%	51%
Percent Newly Certified Receiving Training	23%	18%	16%	22%	31%
New ATAA Recipients*	NA	NA	NA	288	1,115

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

"With wage insurance, the nation's economy as a whole would benefit from shorter spells of joblessness and more efficient reskilling for workers."

earning power, have the greatest incentive to prolong their job search rather than to accept new work at much lower wages. A Canadian pilot wage insurance program reduced unemployment durations by 4.4 percent, on average, according to research by the Social Development and Research Corporation. This could amount to hundreds of millions of dollars in annual savings on unemployment insurance payments in the U.S. context.

Wage insurance also serves as a training subsidy for the worker's new employer. Generalized retraining programs not only fail to guarantee a worker a job but also cost the worker the wages that he or she could earn by accepting new employment sooner. The retraining that a displaced worker receives on a new job is the best kind: it provides new skills that contribute directly to his or her performance in the new job and is thus directly useful not only to the worker but also to the new employer.

Finally, evidence suggests that wage insurance encourages workers to consider different types of jobs and sectors of employment and, therefore, broadens the job search. This is particularly important for displaced workers whose firm-specific skills have declined in value.

Congress took a small step toward wage insurance by offering it to import-displaced workers in the TAA overhaul of 2002, but the new wage insurance program is exceedingly restrictive in scope, and implementation has been nothing short of embarrassing. Only 288 participants were enrolled in the so-called Alternative TAA (ATAA) in 2003, as opposed to more than 43,000 newly eligible participants in TAA. The low enrollment reflects a combination of poor implementation—fewer than half the states had implemented the ATAA program by 2003—and poorly defined criteria that restrict eligibility to workers who "lack easily transferable skills" and yet nevertheless find reemployment within 26 weeks. The objective is to help workers "for whom retraining may not be appropriate" to return to work as quickly as possible.

Because its eligibility criteria are so poorly conceived, the ATAA program should not be viewed as a defining pilot program for wage insurance. We believe that a broader form of 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 firm-specific skills that have lost value because of shifts in demand, technology, or foreign competition. ATAA's restriction to workers over 50 years of age with annual incomes under $50,000 is also counterproductive. Wage insurance should be made available to mid-career workers with valuable general skills and those in higher income ranges (albeit with a cap).

Most programs designed to ease job transitions entail a trade-off between the degree of eligibility targeting and participation rates. While targeted programs should be more cost-effective in principle, targeting requires burdensome eligibility and compliance requirements that sharply lower participation rates and sometimes introduce stigma. The TAA experience argues strongly for a less targeted program implemented through an existing system with proven efficacy, such as the UI system.

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 cap on total annual compensation.

We recommend opening the program to all permanently displaced workers, as defined by the Labor Department Displaced Worker Survey, who have at least two years of tenure at the previous job, which Bureau of Labor Statistics data define as "long-tenure." We also suggest restricting the program to workers displaced from full-time jobs and reemployed full-time, so as to avoid any possible incentive to reduce hours of work.

Further, we recommend limiting the compensation period to the first two years, when on-the-job-training is arguably most concentrated. (Below, we also show cost estimates for a one-year program.) We also recommend starting the clock on the two-year eligibility window after a limited number of weeks of unemployment, while beginning compensation as soon as the worker lands a new job. Taken together, these provisions would give displaced workers greater incentives to take a new job sooner (which should reduce the cost of traditional unemployment insurance), even if it pays less than the previous job.

The replacement rate and the annual cap on compensation determine the kinds of workers who would benefit most from the program. A high replacement rate combined with a low annual compensation cap would provide the greatest benefits to lower-income workers suffering steep losses in earnings, while a lower replacement rate combined with a high annual cap would tilt compensation toward higher income earners.

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. For the most recent wave of offshoring, Frank Levy and Richard Murnane have noted that many of the jobs most vulnerable to offshoring are also the most susceptible to automation. It matters little to the displaced worker what has caused his or her misfortune. Nor

"The consequences of job loss are particularly damaging in import-competing industries, where displaced workers face longer spells of unemployment and greater permanent wage declines than do workers in other industries."

Table 3
Costs per Worker Under Alternative Adjustment Programs

Program	TAA	UI and WIA	ATAA Wage Insurance	Brainard Litan Warren Proposal	Bush PRAs	Skill-Improvement Tax Credit
Maximum Duration	1-1/2 Yrs	1/2 Yr	2 Yrs	2 Yrs	1 Yr	5 Yrs
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, GAO, and Economic Policy Institute.

should it matter for social policy; new technologies can be as redistributive as trade. Moreover, the administrative requirements for limiting benefits to trade-displaced workers, as well as the process of establishing eligibility, would severely undermine the effectiveness of wage insurance, as with TAA.

Table 3 compares the costs and benefits for the average displaced worker of a wage insurance program that replaces 50 percent of earnings losses up to an annual maximum of $10,000 for up to two years with UI, TAA, and other programs. 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 Worker Investment Act (WIA) programs and the comprehensive cost of TAA benefits.

The Bush administration and some members of Congress have proposed Personal Reemployment Accounts (PRAs), which are a cheaper alternative to the benefits now available under UI and WIA. The proposed PRAs would provide a voucher for $3,000 to workers likely to exhaust their UI benefits. The vouchers could be used to purchase reemployment services such as counseling and training or to extend unemployment benefits. For those who find a new job within 13 weeks, unused benefits could be distributed as income—with 60 percent (up to $1,800) distributed when the worker accepts 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 to existing federally funded training vouchers, which amount to $10,000 per worker. And Department of Labor research by Christopher O'Leary and Randall Eberts 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," which could result in short-duration job matches and diminish the prospects for on-the-job training. In contrast, the Canadian wage insurance pilot discussed above did not make workers any more likely to accept the first job they found. Our wage insurance proposal should deliver much greater overall economic benefits than PRAs in the form of more efficient and more durable job matches and incentives for companies to invest in the skills of new hires over a two-year period.

"A comprehensive, incentive-based safety net for displaced workers that encourages rapid reemployment and on-the-job training is good politics for members of both political parties and a smart bet for workers and businesses alike."

Table 4
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: 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 the last 52 weeks.
**** Those holding fewer than 4 jobs since reemployment.
Source: Authors' calculations based on BLS data.

AGGREGATE COST ESTIMATES

The aggregate cost of wage insurance depends on the program design and three key characteristics of the eligible population: the number of eligible workers, the wage loss of those who accept work at lower pay, and the length of unemployment before a worker regains a job (if the two-year window is triggered upon entry into unemployment). Table 4 shows these key statistics for the population of workers with tenure of two or more years permanently displaced from full-time jobs, drawn from the Department of Labor Displaced Worker Survey.

The aggregate cost estimates are shown in Table 5 for different assumptions about the duration of wage insurance payments (one and two years); the replacement rate (30, 50, and 70 percent); and the annual cap of compensation payments ($10,000 and $20,000) over the period 2000–03. One central insight is that the estimated costs of the program are related to the economic cycle, with both the number of displaced workers and the fraction of eligible workers who suffer a wage loss rising during the downturn. Still, the cost of a fairly generous program that provides 50 percent replacement with a $10,000 annual payment cap is reasonable: less than $4 billion a year, on average.

By way of contrast, the state and federal governments paid out $42.4 billion in unemployment insurance benefits in 2003—nearly ten times the estimated cost of a wage insurance program for that year (assuming a two-year program with a 50 percent replacement rate and a $10,000 annual cap). And the costs can be substantially reduced by offering more modest benefits. For a high-unemployment year such as 2003, costs could range from a low of $1.4 billion for a one-year program with a 30 percent replacement rate and a $10,000 cap to a high of $7 billion for a two-year program with a 70 percent replacement rate and a $20,000 annual cap.

CROSS-OVER POLITICAL APPEAL

A comprehensive, incentive-based safety net for displaced workers that encourages rapid reemployment and on-the-job training is good politics for members of both political parties and a smart bet for workers and businesses alike. 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. For politicians who support government-provided safety nets generally, the program we have outlined should have natural appeal, because it effectively supplements unemployment insurance, while possibly shortening spells of unemployment (which may reduce the cost of UI itself) and giving potential employers greater incentives to hire and train displaced workers. For politicians favoring government programs that extend

"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."

Table 5
Wage Insurance Program Costs for 2000–2003 (millions of dollars)

ONE-YEAR PROGRAM

	2000			2001			2002			2003		
Total Eligible	258,000			514,000			452,000			375,000		
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	503,000			772,000			966,000			827,000		
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.

Brookings Events

- 2005 Brookings Trade Forum: *Offshoring White-Collar Work—The Issues and Implications*

  For more information, visit http://www.brookings.edu/es/commentary/journals/tradeforum/agenda2005.htm

aid only for individuals who demonstrate responsibility, our program also should be appealing. The wage insurance subsidy would not kick in *until a displaced worker has found a new job*. As a result, government aid helps those who help themselves.

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*.

FINANCING WAGE INSURANCE

There are a variety of ways to finance the program. We would expect some offsetting savings on unemployment and training programs from more rapid reemployment. The Canadian experience discussed above suggests savings of several hundreds of millions of dollars. In addition, for those workers who are eligible for TAA but prefer wage insurance, 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 above.

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. One possible way to finance the uncovered costs of wage insurance would be through a modest change in the current federal unemployment tax (FUTA) with the incidence split between employers and employees.

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.

Tell us what you think of this Policy Brief.
E-mail your comments to feedback@brookings.edu.

The Brookings Institution
1775 Massachusetts Ave., NW
Washington, DC 20036

NONPROFIT ORG.
U.S. POSTAGE
PAID
FREDERICK, MD
PERMIT NO. 225