ECONOMIC POLICY BRIEF

JOINT ECONOMIC COMMITTEE – DEMOCRATS
REPRESENTATIVE PETE STARK (D-CA) – RANKING MEMBER

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UNEMPLOYMENT BENEFITS AND JOB SEARCH:

THE ADMINISTRATION'S WEAK AND MISLEADING CASE FOR PERSONAL REEMPLOYMENT ACCOUNTS

Glenn Hubbard, the recently departed Chairman of the President's Council of Economic Advisers (CEA), testified in February before the Joint Economic Committee that one advantage of the Administration's proposed Personal Reemployment Accounts (PRAs) over traditional unemployment insurance (UI) is that "traditional insurance encourages workers to wait until their insurance runs out before finding a new job." This language paints a picture of workers who could go back to work anytime they want to, but prefer an unemployment check to a (larger) paycheck and the dignity of work.

Common sense tells us that this language is an insulting and highly misleading caricature of worker behavior, especially in a tough job market such as we have now. But Hubbard presented a chart that seemed to lend at least some support to the proposition that unemployed workers are more inclined to take jobs about the time their benefits run out. Upon closer inspection, however, that presentation too paints a very misleading picture of how traditional unemployment insurance affects workers' incentives.

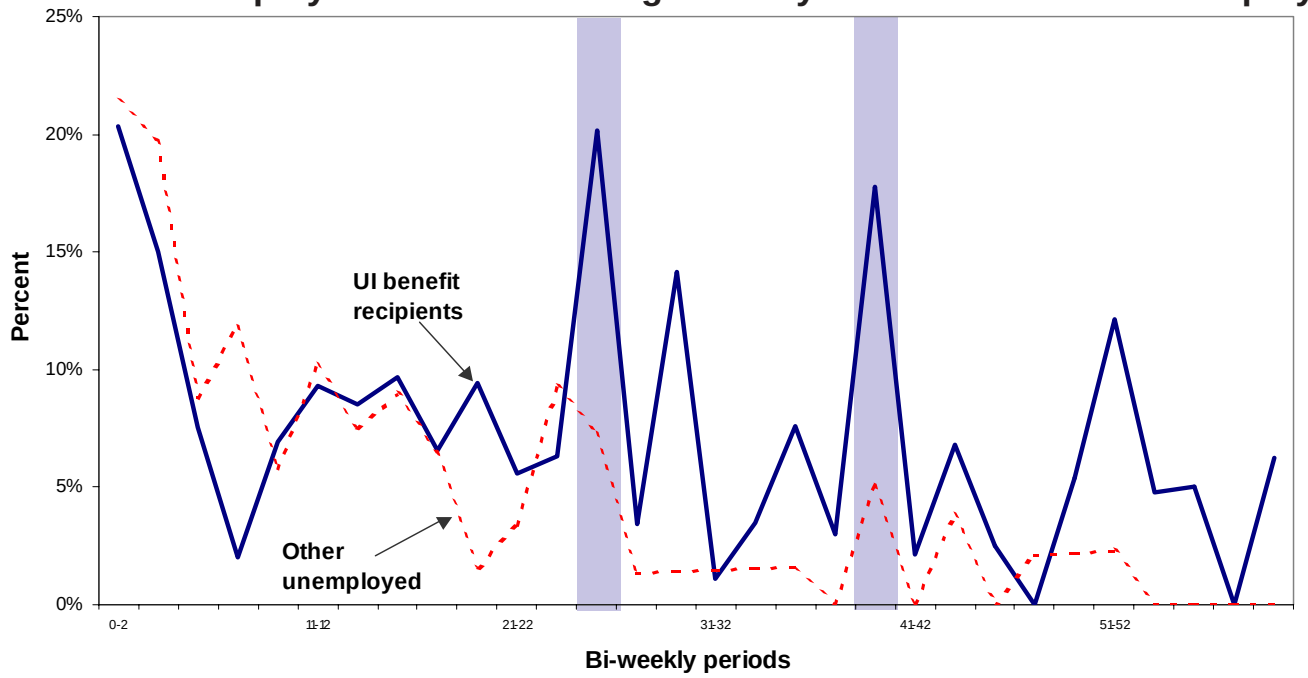
The Data and Their Interpretation

Chart 1 (Panel A) is a reproduction of the Hubbard presentation. The data are from a 1990 study that examined 1980-81 data from the Panel Study of Income Dynamics (PSID), an annual survey that tracks the same people over time.[1] The underlying data are the 703 families in which the head was a job loser and a UI recipient in the sample period (and, separately, the 412 job losers who did not receive UI). The statistic plotted is the re-employment rate by duration of unemployment. In other words, the chart shows the number of people who find work in each two-week period, expressed as a proportion of the number of people still unemployed at the beginning of that two-week period. That "hazard rate" shows a jump around weeks 25-26 (when regular benefits expire) and around weeks 39-40 (when extended benefits expire). What it does not show is that, for UI recipients, over three-quarters of the people in the sample were already back to work by the end of the 24th week of unemployment and more than 90 percent were already back to work by the end of the 38th week.

Chart 1 (Panel B) shows the same data, but in a way that provides a better perspective on whether most workers would rather have a job or would rather wait for their benefits to expire before taking a job. It depicts the proportion of original job losers who are still unemployed by duration of unemployment. This presentation shows that nearly a third of UI recipients were back to work by the end of the first month. By the time their benefits were about to expire, only 159 of the original 703 job losers were still unemployed. The 32 people who took jobs in week 25 or 26 may be a relatively large percentage of the number still unemployed, but they represent less than 5 percent of original job losers.[2] Clearly, most workers do

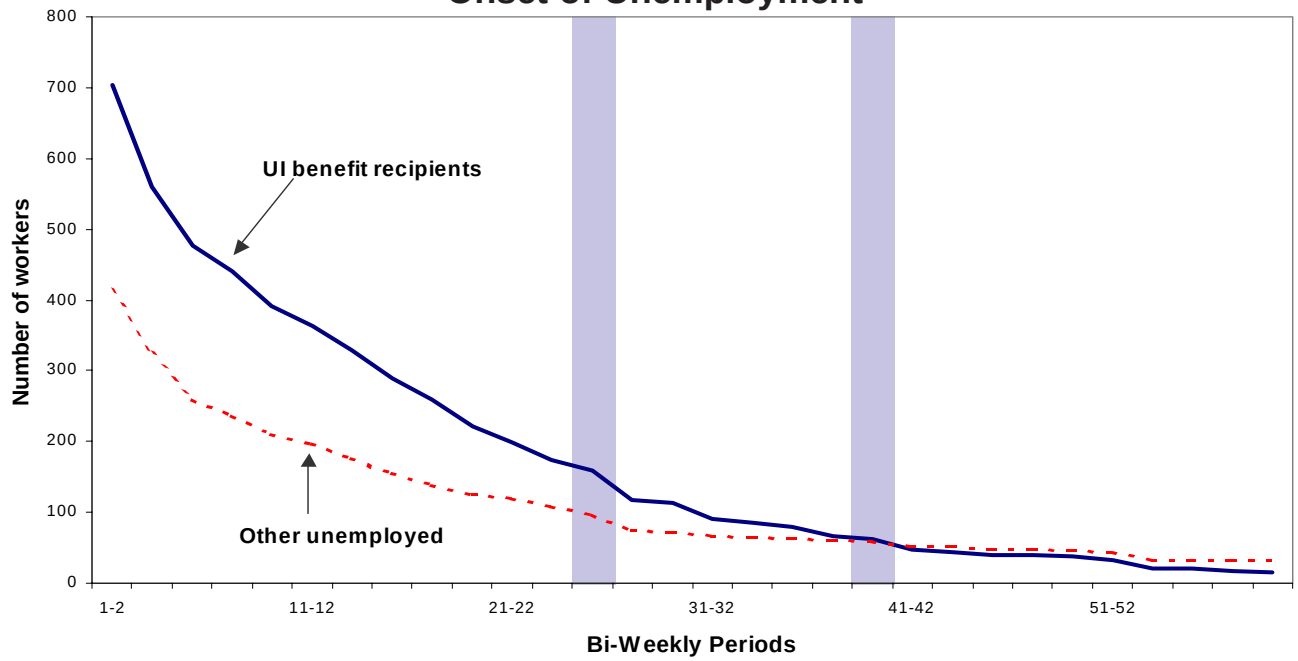
Chart 1
Contrasting Views of the Same Data

Panel A - The CEA Presentation:
Fraction of Unemployed Workers Finding Work by Number of Weeks Unemployed



Note: Shaded areas represent periods when UI benefits expire: regular UI (26 weeks); extended UI or temporary UI (39 weeks).
Source: CEA, *Economic Report of the President*, 2003, from Katz and Meyer.[1]

Panel B - A Better Perspective:
Number of Workers Remaining Unemployed in Bi-weekly Intervals Since Onset of Unemployment



Note: Shaded areas represent periods when UI benefits expire: regular UI (26 weeks); extended UI or temporary UI (39 weeks).
Source: JEC Democrats' plotting original data from Katz and Meyer.[1]

not wait until their benefits are about to expire before taking a job.

The charts also show that the experience of UI recipients is similar to that of unemployed workers who do not get UI. Researchers have found statistical evidence that receiving UI may be associated with slightly longer periods of joblessness, but, properly interpreted, the data clearly show that the magnitude of any such effect is small. A large fraction of UI recipients are back to work long before their benefits expire. Setting the length of unemployment benefits involves balancing the provision of valuable benefits to workers who are having trouble finding re-employment against the risk of creating disincentives to look for work. In normal labor markets, the 26-week limit seems to do a good job of striking the right balance, but in soft labor markets where it is harder to find a job, there is a strong case for extending benefits over a longer period of time.

Federal Reserve Chairman Alan Greenspan made a similar observation in testimony before the Joint Economic Committee last November:

> *But when you get into a period where jobs are falling, then the arguments that people make about creating incentives to work no longer are valid and hence, I've always argued that in periods like this the economic restraints on the unemployment insurance system almost surely ought to be eased to recognize the fact that people are unemployed because they couldn't get a job, not because they don't feel like working.* November 13, 2002

Evidence on Personal Reemployment Accounts

The CEA evidence is part of the Bush Administration's strategy to sell PRAs as a substitute for extended unemployment benefits. In addition to the evidence discussed above, the Administration cites findings from a handful of demonstration projects in the 1980s that evaluate the efficacy of employment bonuses. However, the bonuses evaluated in these demonstrations differ in important ways from the President's proposed PRAs. Moreover, evaluations of these demonstration projects suggest a number of lessons that have not been followed in the design of PRAs.

PRAs are different from the bonuses evaluated in experimental programs. In the mid- to late-1980s, experiments were conducted in three states to test the potential of reemployment bonuses to reduce the duration of unemployment.[3] The researchers evaluating the experiments found a positive but weak link between receiving a bonus and getting back to work faster. The impact of the bonuses ranged from a decrease in the duration of unemployment of 1.2 weeks (in an experiment where the average duration of unemployment was nearly 20 weeks) to a decrease of 0.4 weeks (in an experiment where the average duration was 15 weeks).[4] In only one case was the program judged to be cost effective, in the sense that the reduction in UI costs was large enough to offset the costs of the program. In the other two cases, the savings from reduced UI benefits were not greater than the costs of the bonuses plus the administrative costs of running the program.

The PRAs proposed by the Administration are even less likely to be cost-effective and could be perverse. First, a significant fraction of people who qualified for a bonus in the experiments failed to claim their bonus, reducing the expense of the program. Such an outcome would be less likely in a widely publicized national program like the President's proposed PRAs. Second, and more important, the experimental bonuses tested were straight cash bonuses that went to unemployed people who found and retained new jobs. Those receiving bonuses received no special training or support services, but they were eligible for the services available to all unemployed workers. The Administration's proposed PRAs, in contrast, provide a larger cash

bonus and continued access to training services, but now require workers to pay for training that was previously free out of their bonus. This arrangement creates a perverse incentive to avoid training if workers try to preserve the cash value of their bonus while hoping to get a job quickly, even if that means neglecting training that could upgrade their skills and increase their potential earnings.

Lessons from the experimental programs. The researchers who evaluated the experimental programs also drew lessons about what was likely to work and what was not. Those lessons were not heeded in the design of PRAs. The researchers concluded that a cost-effective program would have the following features: relatively small bonuses, a long waiting period in a new job before the bonus is paid, and careful targeting to those workers most likely to exhaust their UI benefits.[5] However, the President's proposed PRAs are significantly *larger* than the bonuses tested in the 1980s, and they pay 60 percent of the bonus as soon as a person finds a job, withholding only 40 percent until the person has maintained the job for an adequate period of time.

One finding the Administration did incorporate into its proposal was to require states to target PRAs to those workers most likely to exhaust their unemployment benefits. But while researchers have concluded that such targeting would make the program more effective, such targeting of bonuses has yet to be tried and, as with anything new, there are practical issues to be worked out that would delay its effectiveness. Any delay in the implementation of an unemployment bonus program further decreases its ability to help the millions currently in danger of exhausting their benefits this spring.

PRAs are not a substitute for extended UI benefits. The Administration appears to be offering PRAs as a substitute for a further extension of unemployment benefits, the traditional response to the difficulties unemployed workers face in a recession and its aftermath, when labor markets are soft. Once again, however, the experimental evidence is not supportive of such a policy shift. The one demonstration program that was cost-effective took place over a two-year period when unemployment declined somewhat nationwide, not in a weak labor market such as we are experiencing now. An analysis of regional differences in another program found that the effect of bonuses in reducing the duration of unemployment declined significantly to almost nothing in a region with a weak labor market.[6] And by the Administration's own estimate, only one-sixth of the long-term unemployed likely to exhaust regular state UI benefits would be served by PRAs.

Conclusion: Unemployment Insurance is a Better Policy

A balanced reading of the evidence from the demonstration projects is that well-designed reemployment bonuses may have a small positive effect in reducing the duration of unemployment in a healthy labor market. When there are available jobs, re-employment incentives can encourage unemployed workers to look harder (and there is a reasonable probability that an intensified job search will be effective for some). But bonuses or PRAs do not create jobs. In a weak labor market such as we have now, workers may look harder, but the jobs are not there.

In this context, the $3.6 billion proposed by the administration to fund PRAs is not the best policy. Instead, thirteen weeks of additional UI benefits could be funded for approximately the one million workers who have exhausted all UI benefits without finding a job. Such a proposal would provide more direct stimulus and direct relief to workers.[7]

Endnotes

[1] The data comes from work by Lawrence Katz and Bruce Meyer in "The Impact of Potential Duration of Unemployment Benefits on the

Duration of Unemployment," *Journal of Public Economics*, 1990. The Economic Report of the President cites the 1998 working paper version of the article.

[2] Panel B of Chart 1 shows the number of people who are still unemployed at the beginning of each two-week interval, whereas Panel A of Chart 1 shows the *percent change* in that number, expressed as a positive number to emphasize that the change represents people who found jobs. Thus, the same 20 percent hazard rate shown in Panel A of Chart 1 for weeks 1-2 and weeks 25-26 corresponds to very different raw numbers, because, as Panel B of Chart 1 shows, the base number of unemployed is very much smaller in weeks 25-26 than it is in weeks 1-2.

[3] The first was in Illinois from 1984-85, and then Pennsylvania and Washington followed in 1988-1989. A fourth state, New Jersey experimented with a different type of bonus program and is rarely included with the others in evaluations of bonuses.

[4] Philip K. Robbins, "Summary and Policy Implications," in *Reemployment Bonuses in the Unemployment Insurance System: Evidence from Three Field Experiments*, Philip K. Robins and Robert G. Spiegelman, Editors, Upjohn Institute, October 2001.

[5] Christopher O'Leary, Paul T. Decker, and Stephen A. Wandner, "Cost-Effectiveness of Targeted Reemployment Bonuses," W.E. Upjohn Institute, January 2003.

[6] This was found in Washington state. Robert Speigleman, Christopher O'Leary and Kenneth Kline, *The Washington Re-Employment Bonus Experiment Final Report*, W.E. Upjohn Institute, 1992, p. xvii as in National Employment Law Project, " What the Research Says About Personal Reemployment Accounts — A Policy That Fails the Long-Term Unemployed" (Washington, DC February 2003).

[7] Center on Budget and Policy Priorities, "Issues Raised by President's Proposed Personal Reemploymetnt Accounts," February 12, 2003.