

**Adequacy of Benefit Levels and Duration of
Unemployment Insurance in ‘Mild’ vs. ‘Strong’
Recessions**

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Long-Term Effects of Layoffs and Unemployment

- Mild Recessions:
- most unemployment spells are short
 - some suffer large earnings losses & long spells (job loss due to trade, high-tenured/older workers)
 - some with chronic unstable, low-wage work histories

- Strong Recessions:
- long spells of unemployment frequent
 - large earnings losses lasting 15-20 years (von Wachter et al. 2009); large non-monetary costs for health (e.g., Sullivan and von Wachter 2009) and family

- UI System:
- duration and levels probably adequate for ‘typical’ unemployment spell of average worker
 - not adequate for unemployment in larger recessions or for hard-hit workers
 - important differences in dependency on UI benefits among unemployed workers by asset & income level
 - question of adequacy for ‘non-standard’ workers

Key Parameters of UI: (1) Levels of Benefits

Consumption Declines at Unemployment Alleviated by UI:

- Significant consumption declines buffered by UI (Gruber 1997)
- UI income an important source of income (CBO 2004)
- Incidence of poverty increases at exhaustion (CBO 2007)

Calculation of Optimal Replacement Rate:

- Current max. replacement rate: 60%, Average replacement rate: 40%
- Optimal replacement rate: ~50% (Chetty 2008, Leary 1996)
- Trade-Off: a) degree of distortion of employment decision
 b) importance of insurance/ability to self-insure

It appears:

- **Benefits for ‘typical’ worker & ‘typical’ layoff appropriate**
- **Less adequate for long-term unemployed, low-wage/asset**

Heterogeneity in Dependency on UI Benefits

A) Ability to Smooth Consumption via Assets or Credit Matters:

- Lower-income individuals: unable to supplement UI (Leary 1996)
- Long unemployment spells: assets vanish quickly (Gruber 2001)
- Dependency on UI benefits varies considerably in population
- Dependency changes quickly over unemployment spell
- Optimal replacement rate higher for low-asset workers (Chetty '08)
- Optimal replacement rate higher for LTU workers

B) Question of Level of Benefits vs. Relative Replacement Rate

- replacement rate up to 60% for low-income recipients
- yet, basic consumption may take up more than 60% of income
- for higher income workers, even 40% covers basic needs

→ Current UI system both under- and over-compensates workers

Key Parameters of UI: (2) Duration of Benefits

Typical Unemployment Spell in Smaller Recessions:

- Regular UI benefits of 26 weeks sufficient
- Both average rate of take-up and rate of exhaustion is low

Unemployment in Severe Recessions or Hard-Hit Workers:

- Dependency on UI benefits rises:
 - a) lack of suitable jobs
 - b) decline in assets/credit
- Rate of take-up and rate of exhaustion increases
- Disincentives of UI may decline when job situation very bleak
- Extensions via Extended or Emergency UI partly alleviate pressure

Overall:

- **system does address differential UI needs in recessions**
- **however, this system is incomplete in several respects**

Concerns with Current System of Extended UI

A) Current Administration of Extensions is Somewhat Ad Hoc:

- need for automatic triggers recognized
- replaced with discretionary system in difficult times
- no system for hard-hit workers in 'mild' recessions

B) Current approach does not recognize dependency & risks of LTU:

- Long-Term Unemployed at Particular Risk of Labor Force Exit
 - UI Extensions in recessions do not hasten drop out
- Long-Term Unemployed may underestimate wage losses
- Long-Term Unemployed face loss in skills
- May face costs of relocation

→ By ignoring the particular situation of Long-Term Unemployed, current system increases likelihood of costly benefit exhaustions

Challenges Ahead for UI System

Current UI System: good at insuring short-term shocks
 difficulty in addressing longer-term shocks
 does not address needs of non-standard workers

Current Dilemma:

- extended UI gets close to income replacement instead of insurance
 - addresses issue beyond scope of current system
- if nothing is done, many long-term unemployment may
 - apply to other possibly costly programs, such as SSDI
 - face an increasing risk of poverty and adverse health
 - entire family may slip to lower socio-economic status
- need to address issue of non-standard workers:
 - what constitutes 'involuntary' non- or under-employment in today's economy?-

Reform Options for Unemployment Insurance System

Options to Augment Current System:

- a) Reform the way extensions of UI are administered
 - administration of extensions
 - financing of extensions
- b) Reform the way workers likely to exhaust UI benefits are treated:
 - improve job search assistance and training for LTU
 - consider wage insurance/reemployment bonuse
- c) Consider modification in benefit structures & eligibility:
 - vary benefits by worker characteristics, spell duration
- d) Consider prevention of layoffs through Short-Time Compensation
 - prevent costly layoffs before they happen
 - smooth occurrence of layoffs