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 and 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 and 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 bonus

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