

January, 1998
Insight No. 104

Policy Insight

JOBS, NOT UNEMPLOYMENT: REFORMING UNEMPLOYMENT INSURANCE

by William B. Conerly, Ph.D.



CASCADE **P**OLICY **I**NSTITUTE
813 SW Alder, Suite 300
Portland, Oregon 97205
(503) 242-0900



Info@CascadePolicy.org
www.CascadePolicy.org
fax 242-3822

Executive Summary

- Recipients of unemployment insurance react to the economic incentives created by the system. Those incentives tend to lengthen the average duration of unemployment.
- Unemployment insurance taxes are paid primarily by workers themselves. Even though the employers actually write the checks to the government, it is the workers who bear the burden of the tax, through lower wage rates.
- JOBS Plus offers an alternative safety net for unemployed workers. The system is being used successfully for welfare recipients, and can be applied to the unemployed. JOBS Plus uses money that would otherwise pay a person not working; the money subsidizes a new private sector job. The presence of these jobs eliminates the disincentive to job search, because one has to accept such a job or lose benefits.
- Using JOBS Plus could reduce unemployment expenses by 68%, through reduced usage of unemployment insurance, shortened spells of unemployment benefits, and reduced layoffs. The cost of using JOBS Plus is far less than the costs of the present system—a potential savings of over \$250,000,000 a year.
- Implementing JOBS Plus would not lead to lower wage jobs upon re-employment. Evidence from various experiments with re-employment bonuses shows that workers who hurry up their job search do not end up with lower wages.

Introduction

Unemployment insurance increases the Oregon unemployment rate and lowers workers' pay, while making the business climate in Oregon less competitive than in many other states. The system is designed as if re-employment were totally out of the unemployed person's control. Because reality is quite different, the program can greatly encourage people to delay their job searches. Even worse than increasing unemployment, most of the costs are passed on to workers in the form of lower wages, penalizing those who make the most effort, and subsidizing those who make the least.

Oregon's welfare system is moving in the opposite direction: emphasizing work-for-pay rather than pay-for-no-work. A new program called JOBS Plus, combined with a change in attitude at the welfare agency, has led to a massive reduction in welfare caseload.

This paper compares Oregon's present system of UI compensation with implementation of the JOBS Plus program for UI beneficiaries. We estimate total savings to be about 68% of current expendi-

tures. This could immediately translate into lower unemployment taxes, most of which would be passed on to workers in the form of higher wages. Although there is a bit of JOBS Plus usage in the UI system today, it is not enough to truly make a difference. With an ambitious switch to the JOBS Plus system, the workers and the general public of Oregon will see definite benefits.

This paper begins with a look at the behavior of UI recipients, stressing how incentives affect their decisions. Next we describe how UI taxes are passed on to workers. Then we describe the alternative, JOBS Plus, and estimate its cost savings. The next section considers whether JOBS Plus might lead the unemployed to accept low wage jobs. Recommendations for implementation follow.

The Behavior of Unemployment Insurance Recipients

UI recipients cannot be stereotyped. There is good evidence to believe that *not* all recipients are lazy bums trying to milk

the system for maximum benefits at minimum effort. And there is also good evidence that *not* all recipients are dedicated to finding a suitable job as soon as humanly possible. Instead, recipients cover a wide range of behaviors and motivations. Consider a few of the many possibilities other than the stereotypes mentioned above:

- A person who would like to spend two weeks camping during the spell of unemployment, knowing that it may be a year before accruing enough time on a new job for two weeks of vacation.
- A person who wants to spend some time re-roofing the house before looking for work. The person judges that it is more responsible to do the work during a spell of unemployment than to hire it out.
- A former stay-at-home mother, who found that the extra income from working just barely offset the costs of working (including costs not only for clothing, travel and daycare, but also hardship to the family). Even though unemployment insurance does not

How the Unemployment Insurance System Works

Unemployment insurance dates back to the New Deal era. Although it is mandated by federal law, the states have great discretion in setting the details of their programs.

Employers pay taxes into the UI trust fund, maintained by the federal government. Tax rates are set by the state, based on the company's *experience rating*. Experience rating means that a high tax rate is charged to those firms whose former employees' claims sum up to relatively large amounts. A low tax rate is charged to the firms whose former employees' claims are small. The purpose of experience rating is to make companies feel the effects of their layoff decisions, so that they cannot pass the costs of their layoffs onto other companies. However, the tax rates have ceilings and floors, which mean that a number of firms are either paying too much or too little, relative to their own former employees' claims.

Tax rates in 1996 ranged from 1.0 to 5.4% of the first \$20,000 of wages paid per employee. The tax has averaged 2.40 percent in recent years, with a declining trend due in part to Oregon's improving economy.

Workers who are unemployed can claim benefits so long as they were involuntarily laid off or they quit for good cause. Determining which workers' claims are valid is a major administrative cost of running the UI program.

The typical worker is eligible for 26 weeks of benefits, although there are some special programs that extend the benefit period. The worker must meet several conditions to receive benefits. Primarily, the worker must be able and willing to work and actively looking for work. There is no real policing of the job search requirement in Oregon, although each UI recipient must report in weekly. Typically the reports are made by touch-tone phone responses to standard eligibility questions. Some workers are identified by a statistical model as being likely to exhaust their benefits before being re-employed. These people may be required to participate in an orientation seminar and some job search activities.

The amount of benefits a worker receives is based upon his or her prior wages, with floors and ceilings on the benefit payments. The average weekly benefit in Oregon now runs about \$190; the minimum is \$77 and the maximum is \$329.

fully replace her wage income, she finds that collecting UI benefits without working is preferable to finding a new job.

- A person who took early retirement but would like additional income. The person works for a year in a job with a high likelihood of termination, then collects unemployment for the maximum period of eligibility.

The common theme of these examples is that everyone makes choices about whether or not to look for work, and how hard to look. Some people will make decisions based solely on their sense of right and wrong, or based on values related to obeying the rules. But there is substantial gray area, and a number of people are not strongly motivated by adherence to rules. Thus, for a significant number of UI recipients, the

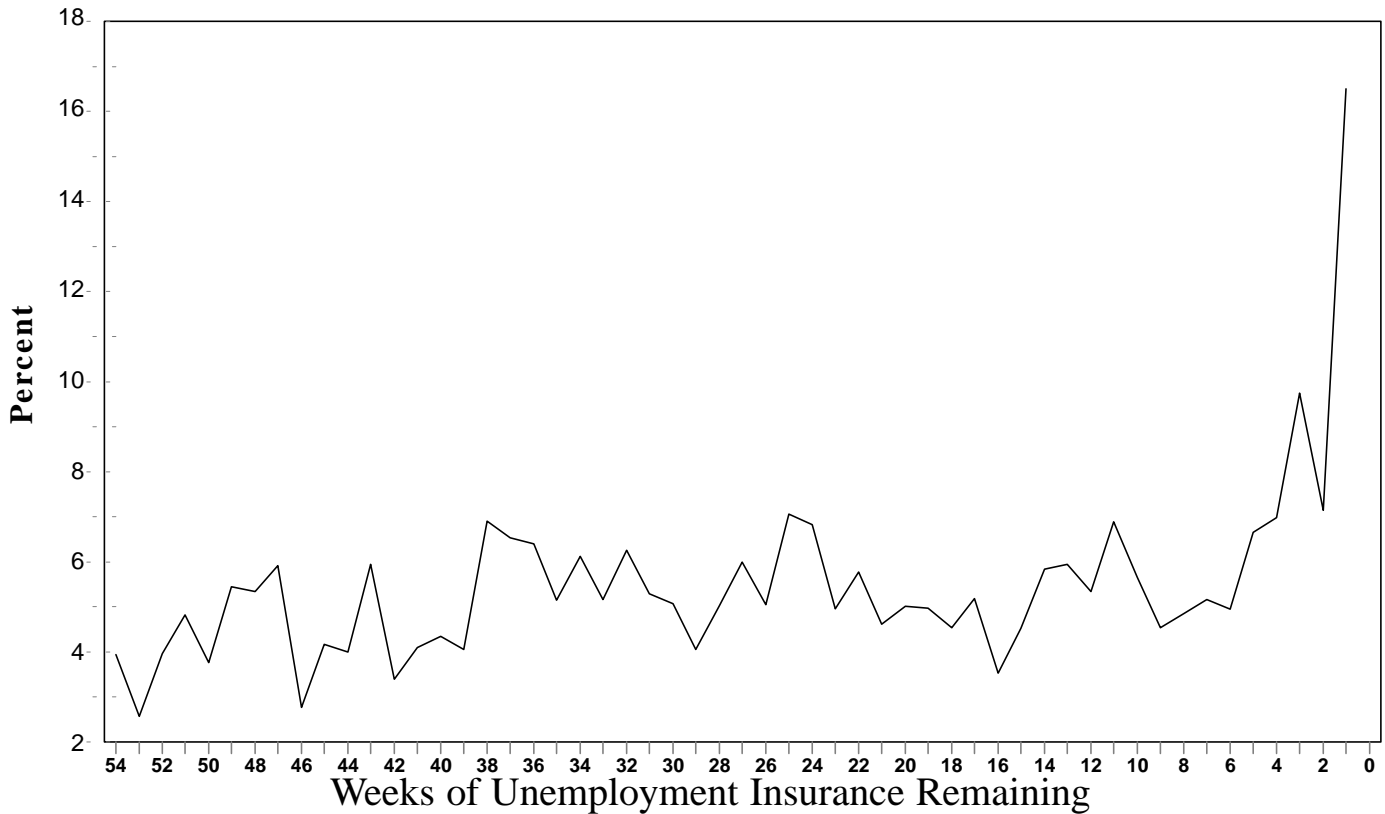
decision is an economic one: the amount of the UI benefit, compared with the value of free time, influences when and how hard unemployed persons look for work.

The UI system requires all recipients to be actively looking for work, to be available and able to work, and to be in the area where they are looking for work. Compliance with these rules, though, is voluntary. Although a small number of recipients are required to have one orientation seminar, one meeting, and one follow-up telephone call, most recipients find collecting UI even easier. Weekly reports are filed by touch-tone telephone, in which the recipient answers questions such as "In the past week, did you look for work? Press one for yes, two for no." There is no distinction made between looking for work half-heartedly and a dedicated job search.

There is ample evidence that the UI system influences behavior; specifically, that it leads to longer periods of unemployment. Academic researchers, even those who support the system, universally conclude that UI benefits have the perverse effect of increasing unemployment.

The following chart, from data published in the academic journal *Econometrica*, shows the probability of a UI recipient finding a job or being recalled from a layoff, based on how many weeks remain of that person's eligibility for UI benefits.¹ The probability triples in the last week of benefits, suggesting that some people wait until the end of benefits to really look for work. (The Oregon Employment Department has examined similar data for Oregon, and finds that a similar spike also occurs in Oregon, but of a less pronounced magnitude. Probability of re-employment moves

Likelihood of UI Recipients Becoming Employed

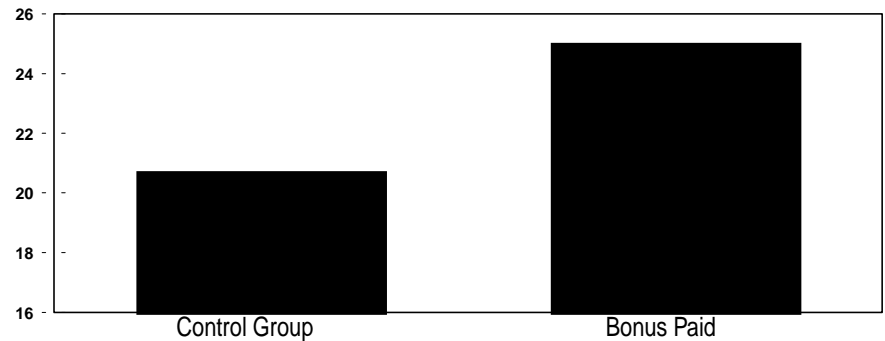


from about five percent for early weeks to nine percent in the last week.²⁾

Consider some of the following conclusions from other academic studies:

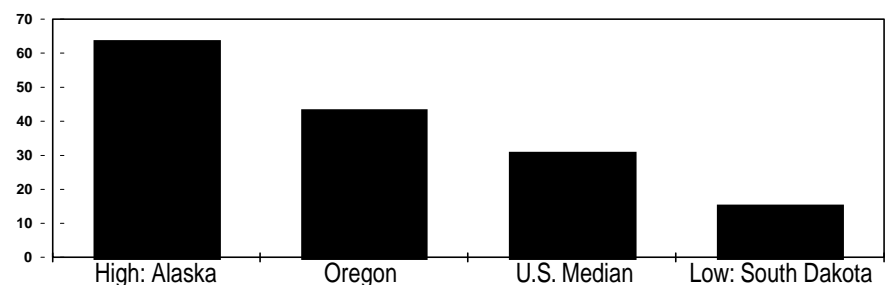
- High UI payments relative to previous wage increase the average duration of unemployment, and increase the percentage of unemployed who collect benefits.³
- Those who are eligible for UI have longer durations of unemployment than those not eligible.⁴
- Experiments in which UI recipients were paid bonuses for finding work succeeded in speeding up re-employment (though not enough to cover the expense of the bonuses).⁵
- More intensive job-search requirements speed up re-employment.⁶

Percent of UI Recipients who Find a Job Within Eleven Weeks



States have significant autonomy to write their own job search requirements, subject to some conformity to federal guidelines. As a result, states vary widely in the degree to which their unemployed use the system.⁷

Percent of Total Unemployed who are UI Claimants



These results clearly indicate the behavior of UI recipients is affected by the UI system. We are not asserting that they are uniformly lazy or irresponsible. We characterize them as reacting to the incentives and disincentives presented to them. For some, the result is intensive job search immediately upon becoming unemployed; for others, it is a low level of job search; and for others, it is no job search at all.

Unemployment Insurance Taxes

The cost of today's unemployment insurance system falls primarily upon the workers of the state, through lower wages and reduced employment opportunities. On the surface, the UI system is financed by a tax on employers, charged as a percentage of taxable wages paid, up to some limit.

This tax is mostly passed through to workers in the form of lower wages. To understand this, imagine an extreme case in which employers can move from one state to another at will, to take advantage of lower wages. In this case, employers lower their offered wage by the difference between this state's tax and the lowest tax available elsewhere. Workers either accept the lower wage, or the company takes its jobs to the lower cost state.

The real world is not quite so stark, but there is substantial sensitivity, in the long run, of employers to the cost of labor. The actual magnitude of these effects is hard to quantify in the long-run, but some rough estimates are available for short-run changes. In the short-run, a change in the UI tax is probably paid 2/3 by workers, and 1/3 by employers.⁸ Once the time period considered lengthens to where companies can enter or leave the state, the burden of the tax will be almost fully shifted to the workers. In addition to causing the state's workers to collect lower wages, the UI tax causes total employment in Oregon to be lower than it would otherwise be.

Elasticities and Tax Shifting

The analysis of how much of an employment tax is passed on to workers, and how much is absorbed by employers, is fairly cut and dried at the formal level. The share of the tax passed on to workers is determined by the labor supply elasticity relative to the labor demand elasticity. An elasticity is defined as the percentage change in quantity caused by a one percent change in price.

In the long run, labor demand elasticity for a region is fairly high, while labor supply elasticity is fairly low. Thus, a change in the tax is primarily paid by workers in the long run. Common estimates of the short-run elasticities are -0.1 to -0.3 for demand and 0.14 for supply. Demand elasticities should be higher at a state level, because production can be shifted out of state when a tax is increased. For our short-run estimate, then, we used the greater elasticity of -0.3. These figures result in two-thirds of the tax being passed on to workers, with the remaining burden carried by employers—and indirectly to consumers as well as company owners.

There are few academic studies on the issue. We have used our own, admittedly rough, estimates, because we have found no academic study that deals with tax incidence specifically at the state level. Researchers should also be cautious regarding older studies, conducted when UI benefits were not taxable.

An Alternative Safety Net for Oregon Workers

There are several viable alternative safety nets for unemployed workers. In this section we explore one: Oregon's JOBS Plus program now being used by welfare applicants. We focus on JOBS Plus because Oregon law already mandates its use for unemployment insurance recipients. Thus, it is the one reform that could be implemented quickly, without Congressional or even legislative action.

First, we should consider the desirable goals of an unemployment safety net. A basic goal of any unemployment safety net should be protection of those workers most in need. The downsized executive with stock options and a year's sev-

erance pay is less in need than a young worker laid off from his or her first job.

Another important goal is to minimize damage done by the safety net. Damage can be done in two ways. First, high taxes, especially employment taxes, discourage demand for employment and are mostly paid by workers in the form of lower wages. Second, a safety net program can provide a disincentive to unemployed people to find employment. Both of these should be avoided.

The JOBS Plus program meets both of these goals: helping those most in need and not worsening unemployment. The program was originally designed for both welfare and unemployment insurance recipients, though its major use so far has been in welfare. In that area, money that would otherwise have gone for cash benefits and food stamp payments is used to

subsidize a private sector job. With some exceptions, welfare recipients are required to work or leave the welfare rolls.

The law that created JOBS Plus in Oregon covers unemployment insurance recipients, but JOBS Plus has not been used extensively in the UI arena. The concept is that money earmarked for unemployment insurance is used to create a private sector job. Instead of being paid for not working, the recipient is paid for work actually performed.

The present unemployment insurance system requires major effort to police applicants. Much of the administrative expense is taken up determining whether a person has left a job for good cause, and is thus eligible for benefits. JOBS Plus will reduce the volume of disputes simply because it can accept all comers. That is, the prospect of receiving pay for working is much less likely to lead to quarrels about eligibility than the present system, which pays benefits for not working. Most applicants will be using the system as a safety net that is inferior to finding their own jobs. For that reason, the system can be open to almost all comers.

The troublesome cases will be those people who make an effort to be unemployable, by showing up at assigned jobs with bad attitudes. There will still be some administrative time taken up with these people, but it should be much less than under the present system.

Reform of the unemployment insurance system will also have to address two areas of administrative practice within the Employment Department: suitability and attachment. Suitability refers to whether a possible job is suitable for a UI recipient. Given the current lack of enforcement of work search requirements, suitability isn't a major concern. With a serious work requirement, though suitability becomes a more important issue. For example, if an unemployed accounts payable clerk had an opportunity to become

Oregon's Welfare Success

Thousands of Oregon families have moved from welfare to work, thanks to Oregon's welfare reform efforts. There have always been people leaving welfare, many of them to take jobs, but the number has increased dramatically in the last three years. In addition, there are many people who now find jobs but who previously would have gone onto the welfare rolls. There are probably 15,000 families over and above normal levels that have made the transformation. Approximately 92% of those families are now paying taxes rather than receiving them. Although welfare caseloads have dropped in most states, Oregon's decline ranks second in the nation, behind only Wisconsin.

How has Oregon done the job? Two elements were critical to the change: new legislation creating the JOBS Plus program, and a new attitude within the state's Adult and Family Services Department (AFS).

Prior to the changes, the welfare staff's main job was to determine eligibility for benefits. They also made referrals to a program called JOBS (Job Opportunities and Basic Skills Training), which was generally ineffective. JOBS was designed to improve the education and work skills of welfare recipients so that they could become self-supporting. However, participation in the program was minimal, and results for those who did participate were not much better than minimal.

JOBS Plus was a different story. As applied to welfare, the program takes money that otherwise would fund cash benefits and food stamps, and subsidizes a new private sector job. Welfare recipients must take a job when one is offered, and JOBS Plus provides the offers. (There are some exemptions from the work requirement.)

At the same time that JOBS Plus was being implemented, AFS personnel made a shift in their own role: they became self-sufficiency counselors. They used the old JOBS program, but emphasized finding work. JOBS Plus was a tool used for those with minimal work experience and skills. JOBS Plus was also a stick: find your own job or one will be found for you.

The twin changes, one of attitude and the other of work requirements, altered the incentives faced by welfare applicants. And with changed incentives, actions changed. Prospective welfare recipients learn about the new requirements when they apply; 40% of the new job placements are to applicants who get their job before they even start on welfare.

an accounts receivable clerk, would that be considered a "suitable" job? A narrow approach to suitability would say no. A broader approach would say that any job which would pay at least as much as the UI benefit would be suitable. We recommend that latter stance as a way to motivate early and effective job search.

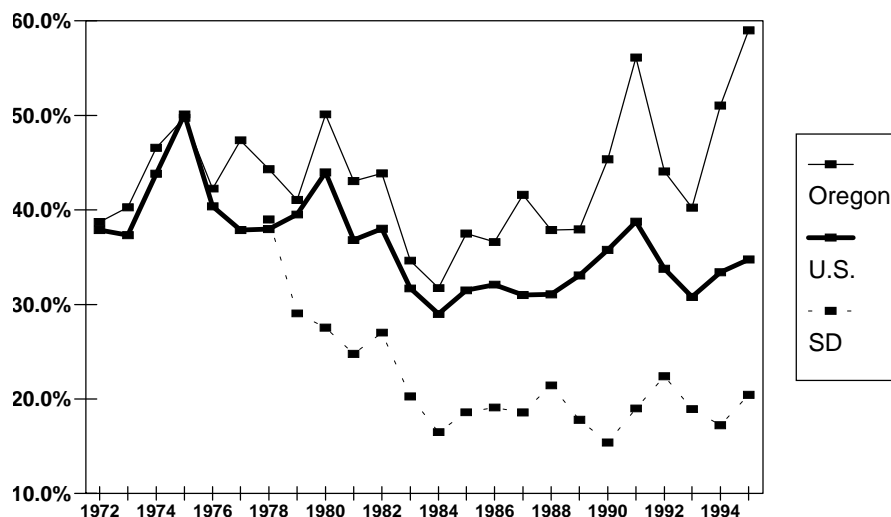
A liberal view of suitability also allows us to get closer to underlying need. The family head who needs money to put food on the dinner table will accept a job, perhaps temporarily, that pays only as much as the UI benefit. However, the unemployed corporate executive may decline to take a job that pays

only \$329 a week, even if that decision requires foregoing any benefits under the unemployment insurance program. That indicates the executive's level of need. Note that under existing practices, those executives whose job loss is softened by two years of severance pay plus accelerated vesting of stock options are fully eligible for unemployment insurance benefits, even while collecting severance.

The second area to address is "attachment," which refers to workers who expect to be recalled from layoff by their old employer. At times this may amount to as many as 75% of UI claimants. One study has found that only 57% of those who expected to be recalled were actually recalled.⁹ Those who weren't recalled experienced much longer spells of unemployment. Policy toward enforcing work search requirements has been quite lenient for those who expect to be recalled. This approach may not be very helpful to those who are not recalled; they would be better off getting on with their job search. Special consideration for attachment also ignores the booming temporary help industry. Today a person with work experience can easily get a temporary job, and thus be available if recalled by the previous employer. At the same time, the worker earns a paycheck, learns something about other employers, and may even get an offer of permanent employment. Given the explicitly limited duration of JOBS Plus employment, it is an ideal backstop for workers who may be recalled.

In the remainder of this section we examine three areas of savings resulting from this system, and then the costs of implementing it. To do so, we begin with a hypothetical group of 1000 potentially unemployed persons. We calculate savings from bringing this group into JOBS Plus, and the cost of serving this group under JOBS Plus. The net savings or extra cost for the group is calculated, and then applied to the overall number of unemployed people in Oregon.

Unemployment: Insured as % of Total



The Reciprocity Rate

The first area of saving is in the reciprocity rate: the percentage of unemployed people who actually claim UI benefits. Not all unemployed people receive UI benefits. Some don't bother to file; others are not eligible. A U.S. Department of Labor study has found substantial state-to-state variation in the ratio of UI recipients to total unemployed. The study also noted very wide variations from state to state in eligibility requirements, as well as in some other factors that affect the reciprocity rate. Oregon's reciprocity rate of 43.3% in 1993 was above the national average of 32%. The lowest state rates were South Dakota at 15.3%, Virginia at 17.0% and New Hampshire at 20.3%.¹⁰ Oregon's rate has been consistently higher than the national average, while South Dakota's, for example, has been consistently lower.

We believe that full implementation of the JOBS Plus program in the area of unemployment insurance would constitute the strictest state requirement in the country. Thus, Oregon's reciprocity rate is likely to fall below the lowest reciprocity rate anywhere. Because we have difficulty estimating just how much lower the reciprocity rate will go, we

make the conservative assumption that Oregon's rate will fall to that of South Dakota, which is the lowest. In terms of our hypothetical group of 1000 potentially unemployed, the number of them collecting UI would be only 35% of those currently collecting. (The 15.3% South Dakota rate, divided by the 43.0% Oregon rate, equals 35%).

Who among the unemployed would choose not to collect benefits? Perhaps the corporate executive with a generous severance package; he or she is now eligible for UI even while collecting a monthly payment from the former employer. Maybe the person on temporary layoff who would rather take a few weeks for personal time than work at a temporary job. Possibly the person who decides to retire at the time that his or her job is terminated. And maybe the person who only wants seasonal work and who is looking forward to having some time off.

Other states which currently have reciprocity rates lower than Oregon's will find that their savings are not as great, because there is less difference between their state and the low reciprocity rate ultimately achievable. The few states with higher reciprocity rates will find even greater savings.

Job Search Intensity

Recall the chart on page 3, “Likelihood Of U.I. Recipients Becoming Employed.” An unemployed person can work hard, or not so hard, at finding a job. Obviously there are some people who wait until the last week of benefit eligibility before finding work, while others are quite anxious to get a job. We believe that under JOBS Plus, people will prefer to find their own jobs as soon as possible, rather than being assigned a job. Those people who currently wait until the last week to find a job will no longer have an incentive to delay looking for a job—they’ll already be working in order to receive unemployment insurance benefits. Thus, all UI recipients will be trying as hard as possible to find the job that’s best for them. Those who want to take some time off without pay or UI benefits can do so with a clear conscience; but once they are ready to work, they will make the maximum effort to find a suitable job.

To estimate the savings from such a change in incentives, we begin with the data charted on page 3, from Bruce Meyer’s article in *Econometrica*. We interpret the likelihood of becoming employed as a measure of job search intensity—how hard the person is trying to find a job. The effort made in the last week of eligibility we assume to be the maximum possible job search intensity. (We don’t really know that greater effort is impossible; but until reforms are made, the conservative estimate is that intensity will not be greater than that found under the current system. A study of Washington state’s experiment with greater job search requirements found that mailing recipients a notice that they would have to attend a two-day job search seminar caused a significant increase in job search effort before the seminar was actually held.¹¹)

First we compute an average duration of unemployment benefits based on the job search intensity found in the Meyer study. Then for an alternate estimate, we assume that everyone’s job search inten-

sity is at maximum effort from Week 1. We re-compute the average duration of unemployment benefits based on this higher level of job search intensity.

The results from these two computations show a major difference. Average duration of unemployment in the Meyer group is 14 weeks; with maximum job search effort, the average duration is only 6 weeks, suggesting a savings of 58%.¹²

Layoffs

Our final savings is based not on the behavior of employees, but on the behavior of employers. In the original design of the system, there was concern that employers might find layoffs more advantageous with unemployment insurance in place. Without UI, a layoff would mean that a company’s workers look for employment elsewhere. But with the UI system, workers can wait to be recalled from a temporary layoff. Because the company has less risk of losing skilled and reliable workers, the UI system might lead to greater layoffs. To offset this incentive, the UI tax rate is set based on a company’s employees’ collection of UI benefits. Thus, layoffs will increase a company’s UI tax rate, which discourages layoffs.

Keying the tax rate to the UI benefits received by a company’s employees is

called “experience rating.” Unfortunately, experience ratings are imperfect for two separate reasons. First, the tax rate changes only with a lag, and interest on an employer’s UI account is neither credited for positive balances nor debited for negative balances. So companies aware of the time value of money will find that a layoff today is paid for with tomorrow’s less valuable dollars.

Second, the tax rates have floors and ceilings. Once a company has a level of UI claims that puts its tax rate at the ceiling, then there is no further cost to further layoffs. Similarly, a company that has an excellent history will pay the minimum tax rate, even though that rate collects more revenue than the costs the company imposes on the system. A small layoff may not increase the company’s cost to the system by enough to raise the tax rate above the minimum, so a layoff is free.

As a result, approximately 5% of the layoffs that actually occur are due to the perverse incentives within the UI system.¹³

Calculation of Savings

The three savings effects we have described so far are consolidated in the following table:

Savings from JOBS Plus Compared to the Status Quo

| | <u>Status Quo</u> | <u>JOBS Plus</u> |
|--------------------------------|-------------------|------------------|
| Potential Unemployed, persons | 1,000 | 1,000 |
| Less reduced layoffs, % | 0% | -5% |
| Actual Unemployed, persons | 1,000 | 950 |
| Collecting Benefits, % | 43.0% | 15.3% |
| Collecting Benefits, persons | 430 | 145 |
| Average Weeks Unemployed | 14 | 6 |
| Total Person-weeks of Benefits | 6,020 | 872 |
| Percentage Difference | | - 86% |

Changing the incentives regarding unemployment could lower the person-weeks of benefits by 86%. That's a huge reduction, of course, but it's only one side of the story. We will look at the cost of the JOBS Plus program below. But first let's put some dollars into the calculations. On the status quo side, the average total benefit per UI beneficiary in the 1990-94 period was \$2518, while administrative costs averaged \$245 per beneficiary, for a total cost of \$2763.¹⁴ For our pool of 1000 potentially unemployed, the UI program entails total costs of \$1,188,090.

What would the JOBS Plus program cost this group? We don't have hard numbers yet, but we can take some information from the cost of serving welfare recipients in JOBS Plus. Keep in mind, though, many welfare recipients have no work experience and need coaching on basic job habits. In addition, they receive child care grants, and counseling. UI recipients, however, by definition have work experience and have their child care needs arranged, so their expenses should be less. The average JOBS Plus worker has received an hourly wage higher than the hourly equivalent of the average UI benefit.¹⁵

The JOBS Plus cost per placement is \$2589.¹⁶ (AFS quotes a figure net of savings from welfare grants and food stamps; our figure is gross costs before savings.) For the 145 people collecting benefits from our group of 1000 potentially unemployed, the total cost would be \$375,405. (This figure is not adjusted for differing lengths of time receiving benefits; thus we assume that UI beneficiaries use the program just as long as welfare recipients did, which is probably an overstatement.)

One "reality check" for using the welfare reform cost estimate is the Job Training Partnership Act (JTPA) programs in the state. These programs for adults average a cost of \$1,987 per worker, according to data in the 1995 annual report

Program Costs per 1000 Potentially Unemployed

| | <u>Status Quo</u> | <u>JOBS Plus</u> |
|--|-------------------|------------------|
| Number participating in program | 430 | 145 |
| Cost per participant | \$2,763 | \$2,589 |
| Total Costs | \$1,188,090 | \$375,405 |
| Percentage Savings from JOBS Plus | | 68% |

for Oregon JTPA.¹⁷ Many JTPA clients have lower skills and more challenges to employability than the typical UI client. If anything, we are making some high cost estimates for JOBS Plus involving UI claimants.

So far we have dealt with our hypothetical group of 1000 potentially unemployed, because it helped us to avoid issues such as whether the economy is relatively strong or relatively weak at any given moment. Now, however, it is time to consider the total UI tax collections and average tax rates in actual practice in Oregon.

Total UI benefits paid and administrative costs from 1990 through 1994 averaged \$380 million per year. To fund the program, the tax rate averaged 2.40% of taxable payrolls.¹⁸ (Individual employers paid varying tax rates, according to their experience rating.) If Oregon achieves a 68% saving in total costs, the tax rate could fall to 0.76%.

Recall our earlier discussion of unemployment insurance taxes, in which we estimated that in the short run, two-thirds of any tax cut would go to workers. Workers would thus find that their wages rose by about 1.1%. Total employment in the state would also increase. Even though wages rise, the reduced UI tax would lower the total cost of employment that businesses face. It is a win-win situation. Overall economic growth in Oregon would increase, as the state's labor became more attractive to employers.

(Although both business and workers generally would benefit from the change to JOBS Plus, some workers would be worse off. Those who regularly use UI and don't care to find a new job as rapidly as possible will find that they either have less money or less time off. The dollar value of benefits to other workers and to business more than offsets this group's loss, but it is a loss to them nonetheless.)

Wage Rate Effects

Would changes in the unemployment insurance system lead to changes in the wage rates at which people take new jobs? It would seem inappropriate to force people into low-wage jobs as a cost-saving measure. However, it is unlikely that JOBS Plus would have that effect.

One theory of unemployment would assume that more job search activity leads to more job opportunities, some of which would be at wage rates high relative to the individual's potential. Thus, people who can spend more time searching for work will find higher wage rates. Conversely, people forced into finding jobs quickly will take unsuitably low-paying jobs.

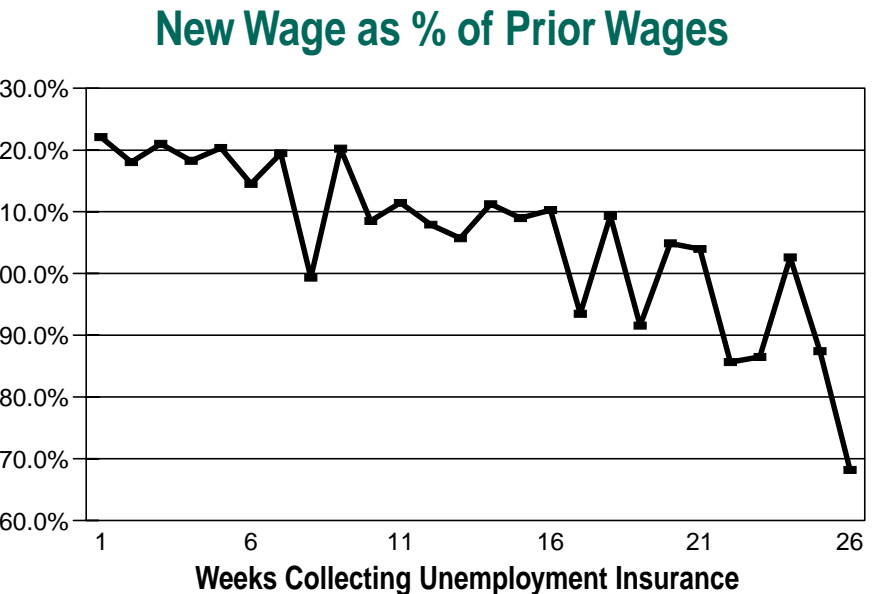
The alternative theories make wage rates largely independent of duration of unemployment. If unemployed people are using a large part of their time for activities other than job search, then compressing the duration of unemployment may squeeze out the other activities, not the job search.

Another theory that leads to the same conclusion assumes that the newly unemployed don't know what they are really worth in the job market, but they guess that they are worth about what they earned in their last job. If a person receives a job offer at a higher wage, he doesn't know if he is really worth more, or if he just received a lucky offer at an abnormally high wage. Similarly, if a low-wage offer is received, he doesn't know if he is worth less than he used to be worth, or if that particular job offer is abnormally low. This uncertainty leads those who are worth more now (relative to their old job) to accept job offers quickly, at higher wages. Those who are worth less, due to changing labor needs in the economy, initially resist the idea, but eventually accept a job at a lower wage rate. In this theory, compressing the unemployment duration may not change the eventual average wage rate each group accepts, it merely speeds up the acceptance of reality.

Academic research on the subject is sparse. One study using data from the 1960s found that the amount of UI payments positively affected the wage rates of new jobs for some demographic groups, but not for others.¹⁹ This study supports the first, higher-wage theory for older workers, but the second, non-job-search theory for younger workers.

Several recent experiments in which bonuses were paid to those who found work quickly showed that wage rates were not reduced by the bonus program. This also tends to support either of the two theories that indicate no significant wage effect.²⁰

Oregon data on wage rates and duration of unemployment tend to also support the no-wage-gain theories of unemployment duration.²¹ (The following discussion has not been subjected to the rigorous theoretical and statistical evaluation of academic research, and should be taken as preliminary.) Actual wage rates



received at new jobs, calculated as a percentage of wage rates at old jobs, tend to decline as duration of unemployment increases. If time unemployed were used to find more, higher job offers, we would expect to see an increasing relationship of wages with duration.

However, if duration of unemployment is inversely related to ambition—as would be the case if the time were spent in leisure activities — then we would expect to find the declining relationship shown by the Oregon data.

Finally, if wage rates taken on new jobs reflect value in a changed marketplace for labor, as in the third theory we sketched out above, then we would expect a declining wage rate as duration of unemployment lengthens: those who take jobs quickly are those who receive high job offers; those who take a long time before accepting a job offer are those who don't believe at first that they are now worth less than they used to be worth. Discouraging them from taking so long to find re-employment would not change the ultimate wage rate that they receive.

So far, this discussion has focused on the initial wage rate of the new job. The more important issue is the future earnings path of the worker. Some people

take a relatively low-paying job in order to get higher wage potential in the future. For these people, initial wage is not a good measure of future earnings. It is worth noting that in their first jobs, college graduates on average earn only a little more than high school graduates. By the time they are 40 years old, though, the college grads are earning 64% more. This suggests that talents and skills are rewarded regardless of initial wage rates.²²

Second, those who currently have jobs are often deemed to be the best candidates for other jobs. Having taken a job quickly after being fired is more likely to look good to another potential employer than having spent six months looking for a job.

A third issue has not been discussed widely in the context of unemployment insurance: the temporary help industry. Of minuscule size when the unemployment insurance system was begun, it now constitutes a major element of the economy. Those who want to take their time looking for the perfect job can take temporary jobs. This de-stigmatizes unemployment, provides income — and often a temporary job becomes permanent.

Overall, there is little evidence to support the concern that reforming the un-

employment insurance system would lead people to take jobs at lower wage rates.

Conclusions

Oregon's unemployment insurance system works to the detriment of most workers in the state, and makes Oregon's business environment less competitive. These costs are imposed because the system provides incentives to delay job search, or to search only halfheartedly, thus raising unemployment. The unem-

ployment insurance tax is passed on to workers in the form of lower wages, so those who are in no hurry to find a job impose a burden on those who search actively and diligently.

The JOBS Plus system, in contrast, provides a safety net for those who truly need it, and encourages rather than discourages people to find jobs. The program needs to be administered by staff who believe that their role is to help the unemployed find jobs, rather than to merely determine eligibility for benefits.

Quantitative estimates of the benefits of JOBS Plus may be greeted with skepticism. Indeed, the author himself is skeptical of much quantitative work in public policy. But this analysis has sought to be fairly conservative. Despite that conservatism, the analysis shows tremendous savings to the workers of the state. We could be off by half in our estimates and there would still be great savings from the program. Fundamentally, these savings are possible because people react to the incentives and disincentives before them.

Sources

Adult and Family Services Division of the Oregon Department of Human Resources, and the Employment Department, "Report on the JOBS Plus Pilot Program," presented to Senate Interim Health and Human Resources Committee, February 27, 1996.

Berck, P., E. Golan and B. Smith, *Dynamic Revenue Analysis for California*, Sacramento, CA: Department of Finance, Summer 1996, pp. 82-87

Brechling, Frank and Louise Laurence, *Permanent Job Loss and the U.S. System of Financing Unemployment Insurance*, Kalamazoo, Mich.: W. E. Upjohn Institute for Employment Research, 1995.

Conerly, William B., "Welfare to Work: a \$153,000,000 Industry," *Your Taxes*, September 1997, pp. 1,3-4.

Deere, Donald, "Unemployment Insurance and Employment," *Journal of Labor Economics*, 9(4), October 1991, pages 307-24.

Economic Report of the President, Washington, D.C.: Government Printing Office, February 1992.

Ehrenberg, Ronald G. and Ronald L. Oaxaca, "Unemployment Insurance, Duration of Unemployment, and the Subsequent Wage Gain," *American Economic Review*, December 1976, pp. 754-766.

Hamermesh, Daniel, *Labor Demand*, Princeton, NJ: Princeton University Press, 1993.

Job Training Partnership Act Administration, *Annual Report 1995*, Oregon Economic Development Department.

Johnson, Terry R. and Daniel H. Klepinger, "Experimental Evidence on Unemployment Insurance Work Search Policies" *Journal of Human Resources*, 29(3), Summer 1994, pages 695-717.

Katz, Lawrence F. and Bruce D. Meyer, "Unemployment Insurance, Recall Expectations, and Unemployment Outcomes," *Quarterly Journal of Economics*, November 1990, pp. 973-1002.

McMurrer, Daniel P. and Amy B. Chasanov, "Trends in Unemployment Insurance Benefits," *Monthly Labor Review*, 118(9), September 1995, pages 30-39.

Meyer, Bruce D., "Lessons from the U.S. Unemployment Insurance Experiments," *Journal of Economic Literature*, 33(1), March 1995, pages 91-131.

Meyer, Bruce D., "What Have We Learned from the Illinois Reemployment Bonus Experiment?" *Journal of Labor Economics*; 14(1), January 1996, pages 26-51.

O'Leary, Christopher J., Robert G. Spiegelman, and Kenneth J. Kline, "Do Bonus Offers Shorten Unemployment Insurance Spells? Results from the Washington Experiment," *Journal of Policy Analysis and Management*, 14(2), Spring 1995, pages 245-69.

Oregon Department of Employment, data file provided May 23, 1997.

Rostamizadeh, Ahmad, *Chronological Summary: Oregon's Unemployment Insurance Program From the Beginning to Date*, Employment Department, Salem, Oregon, April 1996.

U. S. Bureau of Labor Statistics, "The Employment Situation: December 1996," January 10, 1996.

Endnotes

- 1 Meyer, 1990; data are taken from Table IV.
- 2 Oregon Employment Department.
- 3 McCall, 1995.
- 4 Gritz and MaCurdy, 1990.
- 5 Meyer, 1996; Meyer, 1995; and O'Leary et al, 1995.
- 6 Meyer, 1995; see also Johnson and Klepinger, 1994.
- 7 McMurrer and Chasanov, 1995.
- 8 Calculations are based on an assumed labor demand elasticity of -0.30, Hamermesh, 1993, Chapter 3. A labor supply elasticity of 0.15 is used, following the analysis of Berck et al, 1996. Supply elasticities of 0 for men, 0.4 for married women, and 0.2 for single women were averaged using weights based on composition of the U.S. labor force in December 1996, from U. S. Bureau of Labor Statistics, 1996.
- 9 Katz and Meyer, 1990.
- 10 McMurrer and Chasanov, 1995.
- 11 Johnson and Klepinger, 1994.
- 12 Details of the simulation are available from the author.
- 13 Brechling and Laurence, 1995; and Deere, 1991.
- 14 Benefits are detailed in Rostamizadeh, 1996. Administrative cost data were provided by the Employment Department.
- 15 Adult and Family Services Division, 1996, p. 4 reports an average wage rate of \$5.57. The average UI weekly benefit has been \$163.75, which would be \$4.09 per hour for a 40 hour week.
- 16 Calculations based on data provided by Adult and Family Services.
- 17 Job Training Partnership Act Administration, 1995.
- 18 Calculation based on data in Rostamizadeh, 1996.
- 19 Ehrenberg and. Oaxaca, 1976. Older studies, such as this one, should be treated cautiously because of changes in federal tax laws that made UI benefits taxable income.
- 20 Meyer, 1995.
- 21 Oregon Employment Department, 1997.
- 22 Economic Report of the President, 1992, p. 98.

About the Author

William B. Conerly is President of Conerly Whelan Inc., an investment management firm in Portland, Oregon. He was formerly Senior Vice President and Economist for First Interstate Bank. He is also a member of the Governor's Council of Economic Advisors, serves on the boards of directors of Oregon Tax Research and Cascade Policy Institute and acts as a consultant to the American Institute For Full Employment. He holds a Ph.D. in economics from Duke University.

About Cascade Policy Institute

Founded in 1991, Cascade Policy Institute is Oregon's premier policy research center. Cascade's mission is to explore private, voluntary ideas that strengthen Oregon's economy, support personal responsibility, and secure individual freedom. To that end Cascade publishes studies, organizes public forums, and provides speakers. Focusing on local and state issues, Cascade provides practical solutions for concerned citizens, policy-makers and the media. To learn more about Cascade Policy Institute, visit our web site at www.CascadePolicy.org, or e-mail us at Info@CascadePolicy.org.

A 501(c)(3) nonprofit organization, Cascade neither solicits nor accepts government funding, but instead relies entirely on private contributions from individuals, corporations and foundations. Tax deductible donations are welcome to support the work of the Institute.

Nothing written here should be construed as an attempt to aid or hinder the passage of any legislation or as an endorsement of any candidate or initiative.

This report was authorized and produced by Cascade Policy Institute and was printed in association with the American Institute for Full Employment. Permission to reprint granted provided proper credit is given.

CASCADE POLICY INSTITUTE
813 SW Alder, Suite 300
Portland, Oregon 97205
(503) 242-0900
www.CascadePolicy.org

AMERICAN INSTITUTE FOR FULL EMPLOYMENT
PO Box 1329
Klamath Falls, Oregon, 97601
(800) 562-7752
www.Fullemployment.org