



The Value of Wage Insurance in an Era of Disruptive Economic Change

[An Analysis of the Scientific Merits of a Wage Insurance Policy]

Author: Jessica Young
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Exploring Wage Insurance as a Policy Solution

Wage Insurance is one of many potential policy solutions that could be used to mitigate the impact of disruptive economic changes (from globalization to technological change) as they fall unevenly upon workers in the U.S. However, wage insurance fills a unique void: serving highly tenured workers likeliest to face steep long-term wage loss, the audience most adversely impacted by job displacement. While policy instruments such as reemployment programs could potentially shorten workers' unemployment duration, and training programs could raise annual earnings to a minimal extent, neither address large wage losses endured when displaced workers must accept alternative positions paying far less than their previous pay.ⁱ In some industries, such as the trucking industry, where workers have honed skills specialized to a niche job, this wage loss could be as much as one third of one's previous pay.ⁱⁱ

Leading economists such as Robert LaLonde and Lori Kletzer have been vocal proponents of employing a wage insurance program in the U.S. Such a program would require all workers to contribute to an insurance fund which would insure them for a percentage of their wage loss if their job was displaced by automation. Receiving benefits would be conditional upon re-entering the workforce by finding another job, and benefits would only be paid to those reemployed at a lower wage level. This paper considers the science-based merits of such a proposal.

Correcting for Market Failure

The implementation of a wage insurance program could benefit society first and foremost by correcting for market failure. In doing so, it would address the failure of private markets to provide insurance protecting workers from the serious and costly risk of job displacement. The private market naturally fails to do so given adverse selection; workers who deem themselves to have a low probability of displacement or significant wage loss would opt out of participating. This would in turn leave private insurance companies to incur financial losses when left to cover exclusively those negatively impacted. As LaLonde notes, "trade liberalization, growth promoting economic policies, or even well-designed environmental standards that benefit most in our society can have adverse effects on some workers."ⁱⁱⁱ When this is the case, and private markets fail to support those adversely affected, it is the role of governments to intervene on behalf of, and to protect, their constituents. In these instances, a sound policy instrument is needed to redistribute the gains of an evolving economy from those who disproportionately benefit to those who disproportionately lose from the change.

Anticipating Likely Costs

When anticipating likely costs, we can first evaluate the bare minimum on which such a program could operate. In his report for the Council on Foreign Relations, LaLonde estimates that a two-year program providing 50% coverage would cost roughly \$3-4 billion per year (around 10% of the amount spent on annual unemployment insurance benefit payments).^{iv} However, this would be largely insufficient to address the program's goal: mitigating substantial wage loss incurred

over the long-run. If such a program were extended to provide coverage for a four-year duration, this is forecasted to cost roughly \$6-8 billion per year. While four years of payments to offset wage loss would be beneficial, an optimal program would provide coverage for a period of five years or more. To finance such costs (e.g. \$15-16 billion for a six-year duration), the program could secure additional funding via a monthly tax (i.e. an insurance premium) of \$2-\$3 collected per worker.^v While such a tax could be financed by the employee or his/her employer, the former would be advantageous in that it would allow the displaced worker's wage insurance benefits to be exempt from income taxes. Finally, policymakers could re-channel funding currently provided to retraining programs. Doing so would allow displaced workers to then use the wage insurance benefits to supplement their earnings, or to enhance their education if they so desired (for instance through community colleges or technical programs). In addition to enhancing the allotment of funds for a wage insurance program, this would simultaneously improve the parameters of technical training programs (which are currently only extended to the unemployed, rather than the unfavorably re-employed as well).^{vi}

Forecasting Expected Benefits

When considering the expected benefits that a wage insurance program could draw, we find strong evidence for three key benefits. First, by the very nature of the program and its terms, wage insurance would offer a safety net for displaced workers. Second, it would provide workers a strong incentive to take up new jobs rather than drop out of the labor force. Economists Autor, Dorn, and Hanson, who have extensively studied labor market shocks and worker responses, estimate that roughly 9.9% of those who lose their job fake disability in order to collect Social Security Disability Insurance (SSDI). This provides reason to hypothesize that a wage insurance program could result in a reduction of SSDI payments by motivating a significant percentage of displaced workers to re-enter the workforce.^{vii} Third, a wage insurance program would cover a particularly vulnerable audience facing long-term wage loss over the rest of their career – a concern not addressed by unemployment insurance schemes, and an audience not likely to be well served by retraining programs. Figures 1 and 2 of this paper's appendix show just how significant this wage loss can be for highly tenured workers. Finally, while less scientific, a strong case can be made for the likely benefit that a wage insurance program would, in the words of LaLonde, “allay workers’ fears of displacement and, as a result... reduce resistance to policies conducive to economic growth.”^{viii}

Drawing on Evidence to Anticipate Success

In attempting to gauge and anticipate the likely success, or lack thereof, for a wage insurance program we can draw on both economic evidence supporting efficient spending as well as historical evidence supporting political viability. First, we know that policies that incentivize workers to search for productive jobs will be most efficient in terms of optimizing government expenditure relative to return. Incentivizing workers to re-enter the labor market post-displacement not only reduces benefit payouts, but also results in more workers employed in the

workforce and contributing to GDP. LaLonde finds, by limiting benefits to 50 percent of the pre- and post-displacement earnings, most displacement insurance proposals provide incentives for displaced workers to search for more productive jobs at higher wages.” Second, we note that the US government successfully launched the Alternative Trade Adjustment Assistance program in 2003, offering recipients 50% coverage on the difference between their pre- and post-displacement wages (though limited to a max benefit of 10k over two years).^{ix} This indicates that wage insurance may very well be politically viable, especially as the threat of job displacement due to technological change (be it from automation or artificial intelligence) mounts. Displacement due to such change will become a nonpartisan issue impacting “red” and “blue” states alike, thus lending more weight to the case for political viability.

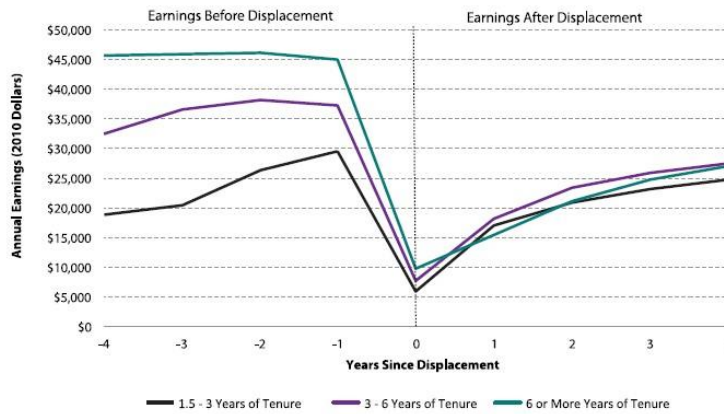
Closing Policy Recommendation

Weighing the above, political leaders should explore wage insurance as a proactive solution for job displacement due to the diverse merits such a program would offer. These include (1) responding to a market failure; (2) providing significant benefits in terms of worker protection, equity, and economic efficiency; (3) having feasible funding mechanisms, and a non-prohibitive implementation cost; and (4) promise of success and political viability. Not only is the need for such a policy instrument strong today (to protect highly tenured workers and those prone to large wage loss over time), the need will continue to mount with technological change and market disruption on the horizon. The US in particular is a prime candidate for such a program given that falls among the top countries with high earning inequality whose markets reward a relatively high return to skills.^x To ensure its highest likelihood of success, such a program should embrace the following terms: requiring mandatory participation; open to all displaced workers who find re-employment at a lower rate; covering a loss period of at least five years; providing 50% wage loss coverage; and operating at the federal level. While states could implement such a program individually, we see potential for bi-partisan appeal given that populations across the nation will be adversely impacted, and we note greater feasibility for obtaining sufficient funding should the program be implemented federally.

Appendix

Figure 1

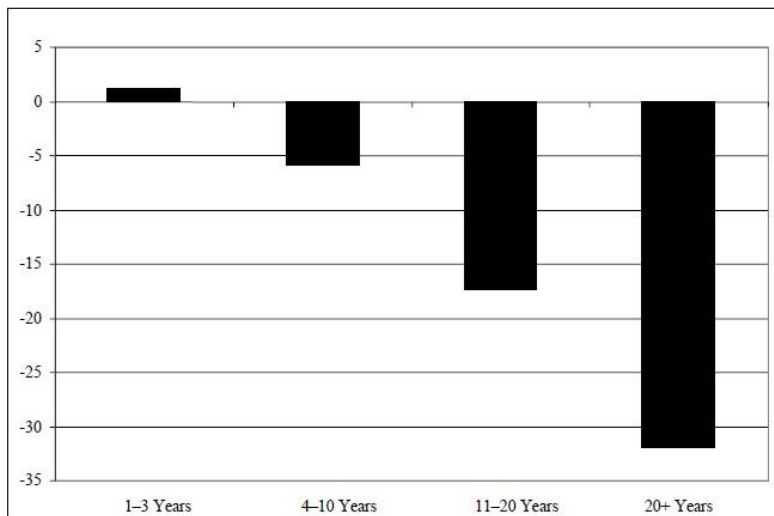
FIGURE 1
Earnings of Displaced Workers by Prior Tenure



Source: Jacobson, Louis S., et al. “Earnings Losses of Displaced Workers.” *The American Economic Review*, vol. 83, no. 4, 1993, pp. 685–709.

Figure 2

Figure 1: Percentage Difference Between Wages Post- and Pre-Displacement, by Tenure with Pre-Displacement Employer



Source: Author’s calculations using Henry Farber (2004), Table 3, page 24, based on calculations from the U.S. Bureau of the Census 2002 Displaced Worker Survey.

Source: LaLonde, R. “The Case for Wage Insurance.” *Council on Foreign Relations*, No. 30, 2007, pg. 8.

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- i LaLonde, R. "The Case for Wage Insurance." Council on Foreign Relations, No. 30, 2007, pg. 19.
- ii Doanvo, A. et al. "Impact of Autonomous Trucking Technology in the United States." May 2018.
- iii LaLonde, R. "The Case for Wage Insurance." Council on Foreign Relations, No. 30, 2007, pg. 14.
- iv LaLonde, R. "The Case for Wage Insurance." Council on Foreign Relations, No. 30, 2007, pg. 24.
- v Ibid.
- vi Ibid.
- vii Doanvo, A. et al. "Impact of Autonomous Trucking Technology in the United States." May 2018.
- viii LaLonde, R. "The Case for Wage Insurance." Council on Foreign Relations, No. 30, 2007, pp. 12-19.
- ix Ibid.
- x Ibid.