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Congressional Testimony on Helping the Long-Term Unemployed
before the
House Committee on Ways and Means, Human Resources Subcommittee

30 April 1992

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Overview

I am honored to have this opportunity to comment on the new UI bill. In my view this bill does an excellent job of providing the means to reestablish the balance between costs borne by unemployed workers and those borne by society at large, as well as the balance among the three basic types of assistance for the long-term unemployed: cash payments, job search assistance, and retraining. In addition, the bill provides the flexibility needed to develop new, highly effective, forms of assistance. But unless steps are taken to insure that states receive feedback on the effectiveness of various types of assistance the bill could fail to establish programs that would deliver adequate services to the long-term unemployed.

Reestablishing the balance between costs borne by the unemployed versus costs borne by society is appropriate. The availability of unemployment compensation and supportive services to aid the long-term unemployed seriously deteriorated over the past ten years. During this same period the substantial restructuring of major US industries increased the need for such assistance.

Through the REAP program the bill provides the means to restructure key institutions to effectively deal with future problems. This too is highly appropriate. Restructuring of the US economy will continue to cause major dislocations in response to the decline in domestic defense spending, as well as changes in international competition, such as those stemming from the North American Free Trade Agreement (NAFTA).

Another positive aspect of the bill is that it gives states wide discretion in implementing effective programs. There is growing recognition that federal restrictions on state and local programs were counter-productive. But more could be done to encourage innovation. In addition to returning a portion of the UI payroll tax to the states I suggest creating a separate fund to be distributed by the US Department of Labor for use by states to try-out, potentially highly effective, but unproven strategies. In particular, wage subsidies might dramatically reduce the costs of dislocation borne by workers and government. Yet, in the absence of federal assistance, states are unlikely to bear the risk of using new approaches.

The one glaring omission from this bill, however, is that it does nothing to insure that states competently monitor program effectiveness, and then overtime, modify the programs to better meet the needs of the long-term unemployed. Providing adequate feedback is a key

aspect of effective policy design, but unfortunately, often overlooked. As a researcher I am acutely aware of the lack of solid information needed to refine policy instruments, but also am struck by the growth of our technical ability to provide reliable information at a tiny fraction of the total cost of these programs.

Last time I spoke in front of this committee Desert Storm had just begun and I noted the analogy between the fog of war and lack of accurate information about the effectiveness of social programs. Over the past few weeks, however, a great deal of the fog of war has lifted as Congress reviewed the military's own analyses of what actually happened. A critical review is essential to avoid repeating mistakes. Given that war places the lives of hundreds of thousands of young Americans at risk, we expect no less.

The irony is that the lives of millions of American families are placed at risk by economic changes, but insufficient attention is given to the effectiveness of government programs aimed at saving those lives. Thus, my most important recommendation is for the US Department of Labor (DOL) to be given the mandate and the resources needed to rigorously evaluate services under REAP and other programs to aid the long-term unemployed.

The remainder of this statement amplifies the above remarks.

Extending Unemployment Insurance

The protection offered by the Extended Benefit (EB) program has seriously deteriorated over the past ten years. EB triggered on in all states that were hard hit by unemployment 1979 through 1982. But except in a few isolated instances, EB has not triggered on during the current recession.

In many states the current recession is milder than that in the early 1980's. But in states where recent economic conditions would have triggered EB in the early 1980's institutional changes prevented the program from taking effect. The level of the Insured Unemployment rate (IUR) required to trigger EB was raised one percentage point in 1981. More important, the IUR fell in relation to the Total Unemployment (TUR). In 1979 close to 2 out of 5 unemployed workers received UI, in 1989 only about 1 out 5 received UI.

The insured unemployment rate fell largely because of changes in the UI system that made receiving UI more difficult. Thus, greater economic distress is now required to trigger EB than formerly. Redressing the institutional changes is important to reestablish a reasonable balance between costs borne by workers and those borne by society at large. But adjusting the trigger is not quite as simple as suggested in the new bill.

Switching from the IUR to the TUR poses a technical problem. The Current Population Survey (CPS) based TUR is not accurately measured for every state. Using CPS

measures with high variance to allocate millions of dollars has led states to successfully sue the federal government to establish "fairer" measures. But even ignoring the threat of litigation, a high variance measure has the undesirable attribute of causing purely statistical gyrations that would cause EB to trigger on in one quarter, and then trigger off the next without any real change in economic conditions.

Expanding the CPS could eliminate the above problem, but would be expensive. On obvious alternative is to lower the IUR trigger. A problem with that approach is that the trigger would have to be changed periodically to insure EB would trigger-on during comparable downturns.

A better alternative would be to retain use of the state IUR as the EB trigger, but automatically adjust the trigger threshold so that the trigger would be "pulled" at a constant national TUR level. Use of the national IUR/TUR ratio to adjust the state trigger would make it easier for EB to trigger-on in states where the IUR/TUR ratio fell less than average since 1979, but the switch to the TUR would make it harder for EB to trigger-on in such states. In my view during a recession it is appropriate to provide more assistance to states that bear larger UI payment burdens.¹

The provisions in the new bill to continue Emergency Unemployment Compensation (EUC) and insure an orderly phase-out also are in keeping with protection offered in the early 1980's. In addition to EB triggering-on in high-unemployment states, the Federal Supplemental Compensation (FSC) program added additional protection. Thus, in the early 1980's most workers in severely distressed areas were covered by 26 weeks of regular UI, 13 weeks of EB, plus 13 weeks of FSC.

Job Search Assistance

The most innovative element of the new bill is funding a Reemployment Assistance Program (REAP). I am enthusiastic about this measure because it has the potential to restore resources that formerly were available for reemployment services through state Employment Services (ESs). The federal ES budget declined by about 10 percent in inflation adjusted dollars over the last decade. At the same time the mission of the ES was expanded and overall use of the ES often increased. In Pennsylvania, for example, resources per ES registrant fell about 25 percent. As a result state ES's became so strapped for resources they

¹ A minor drawback even of this approach is that changes in the UI system are not the only factor affecting the IUR/TUR ratio. Some of those factors, such as changing demographics, could be taken into account by using the ratio of the IUR to the CPS unemployment rate for prime-age workers.

were forced to close offices, cut back some services, and discontinued others including counseling and job search workshops.

Yet research performed by Arnold Katz of the University of Pittsburgh and me has shown that the Pennsylvania ES provided highly cost-effective services to the long-term unemployed. The accuracy of those findings are supported by the only other major ES evaluation—a 29 state DOL study completed about ten years ago by Terry Johnson and his colleagues at Stanford Research International (SRI).

Careful reviews of the literature on assisting dislocated workers conducted independently by Duane Leigh of Washington State University and Robert Lalonde of the University of Chicago reached very similar conclusions. They both found that job search assistance was equally effective as retraining, just far less expensive. Each ES placements costs only about \$250. Job search workshops and job-finding clubs often are even less expensive per participant.

These results make perfect sense. There is overwhelming evidence that the long-run earnings reductions experienced by dislocated manufacturing workers is strongly related to whether or not those workers find similar jobs. For example, Bob Lalonde, Dan Sullivan and I found that in Pennsylvania dislocated manufacturing workers with at least five years of tenure experienced earnings reductions of about 25 percent if they found manufacturing jobs. If, however, they left the manufacturing sector, reductions were 45 percent, 20 percentage points more.

It is reasonable to believe that high tenure workers have rusty job search skills as well as overly optimistic expectations concerning the initial pay of jobs they could obtain. Thus, effective job search assistance could reduce the duration of joblessness, and most important, ultimately lead workers who otherwise would end up in the non-manufacturing sector to manufacturing jobs. The above evidence suggests returning to the manufacturing sector would on average boost earnings by 20 percentage points.

An important reason that job search assistance is under-valued is the widespread, but erroneous, view that "good" jobs using displaced workers' existing skills are unavailable during a recession. Fortunately, studies using plant level data are beginning to dispel the notion that hiring ceases during periods where industry employment falls sharply. When employment is partitioned into growing and declining plants it is evident that growing plants in declining industries experience large net employment increases.

Even more persuasive evidence is derived from tracking plant level entrances and exits of individual workers. For example, my research showed that from 1979 through 1983 manufacturing firms in Pittsburgh hired workers equal to 15 percent of 1979 employment, even though overall manufacturing employment declined by 30 percent during that period.

Only a small part of the hiring was due to plant expansions. Most of the hiring was required to replace workers who voluntarily quit or retired. This means that there were plenty of opportunities to remain in manufacturing during a period where the steel industry experienced one of the most precipitous declines in history.

That many hiring opportunities exist during a recession does not negate the conventional wisdom that recessions substantially reduce hiring. From 1986 through 1989, a relatively prosperous period in Pittsburgh, hiring in manufacturing equaled 40 percent of 1986 employment, more than twice recessionary levels. But the increased competition for available manufacturing jobs in a recession is likely to increase, not diminish, the importance of job search assistance.²

Training

Over the last ten years funding for UI compensation and ES job search assistance fell relative to the demand for those services. In contrast, federal funding for training programs targeted on the long-term unemployed rose substantially under title-III of the Job Training Partnership Act (JTPA) and its successor the Economic Dislocated Worker Adjustment Act (EDWAA).

EDWAA programs spend considerable sums on job development (direct placement), job search assistance, and counseling. Thus, they potentially could fill the gaps created by the decline of the ES. But EDWAA is not an adequate substitute for ES assistance. Vocational training is EDWAA's core service. As a result the average cost per enrollee is over \$2,5000, and therefore, the program can aid only a small fraction of the long-term unemployed.

Further, EDWAA lacks the close contact with the long-term unemployed of the UI-ES system. UI claimants are periodically called in for interviews to monitor job search, but are not necessarily referred to EDWAA. This is beginning to change as states integrate ES and JTPA operations. Even the President has taken note of the value of one-stop shopping for adjustment services. But, in contrast to the administration's proposal, REAP provides the funding needed to improve services.

² Admittedly, there are isolated labor markets where the demise of major employers creates situations where there are almost no jobs available. For example, even today the economic devastation in the Mon Valley close to Pittsburgh resembles that of Ruhr Valley at the end of World War II. Even the most skillful job search limited to those areas often would be fruitless. But retraining would be equally unlikely to lead to local hiring.

In my view a fundamental problem with EDWAA is that the merits of alternative services have not been carefully evaluated. As noted above, there is considerable evidence that the emphasis on training is misplaced. Although some of the long-term unemployed need extensive assistance, most experienced workers who received job search assistance and counseling obtain no additional benefit from short-duration training. Indeed, by unnecessarily delaying the return to work training could slow adjustment.³

I believe that the emphasis on training is largely a result of the erroneous view that displaced workers lack the skills needed to obtain relatively high paying jobs. That view is based on a kernel of truth—that new jobs offering high pay require considerably more education and training than in the past. But, as noted above, this does not mean that the only jobs available require considerable retraining. Further, it is unreasonable to believe that a EDWAA training which is rarely as long as six months can provide high-paid, blue-collar, job losers with the skills needed to obtain "new" high-wage jobs.

My research, and that of others suggest that the earnings of dislocated high-wage, blue-collar workers permanently fall well below what they would otherwise have received, but still are within the range of most workers with similar education and experience. If training could substantially boost the earnings power of dislocated workers, there would be an enormous clamor for such training from workers who never held high-wage jobs.

A much more reasonable view of the capacity of training to raise wages is to assume the rate of return on such training would be about seven percent. Seven percent is at the high end of estimates of the rate of return from any type of education or training. Given a \$5,000 investment by government coupled with a \$15,000 investment in terms of foregone earnings by the trainee would raise annual earnings by \$1,400.

In contrast, the expected return from helping manufacturing workers locate jobs that can use existing skills is close to \$10,000. Following this line of reasoning to its logical

³ The basic point here is that most, but not all, of the long-term unemployed can be adequately helped by inexpensive job search assistance. Nevertheless, there is an important niche for short-duration training of experienced workers. For example, some workers can rapidly gain sufficient skill to induce employers to offer them jobs that otherwise would have gone to others. Also, some workers can boost basic education skills that greatly enhance future opportunities to learn on-the-job or in classroom programs. Periods of unemployment are ideal times to make those additions to human capital.

Also the value of vocational and basic educational training may be considerably greater for economically disadvantaged workers who never held good jobs. This is the main target of JTPA. Even if the value of job search assistance and counseling is undervalued for this group, the rationale for training disadvantaged workers is much stronger, and helping such workers find jobs without training is a less attractive option.

conclusion an investment in training of \$140,000 would be needed to generate a similar \$10,000 gain.

\$140,000 is a lot of money, but it is precisely the type of investment made by anyone who attends college full-time instead of entering the full-time workforce. Few dislocated workers are in a financial position to make that type of investment. Thus, dislocated workers who want substantial retraining must do what a majority of community college students do—combine training with work.

The need for income support while taking training suggests to me that DOL programs should be aimed at providing the long-term unemployed with a realistic assessment of how much they would benefit from retraining and how they could get that training, but at the same time, help workers find the best available jobs. In most communities there are sufficient retraining resources to make combining work with training a viable option.

The alternative of providing income support in addition to paying for retraining is likely to be prohibitively expensive. Trade Adjustment Assistance (TAA) is the only DOL program that even comes to providing adequate support for long-term training. In Missouri TAA eligibles taking training received on average a stipend of \$20,000.

Further, providing stipends creates incentives to take training purely to receive income support. In Missouri it was unclear whether those who took training did so because they felt the training would have a high payoff, or because they felt the income support was more desirable than taking the best available job. This is hardly surprising. Prior to late 1988 TAA training was voluntary, but TAA certified workers who took training could receive the equivalent of 76 weeks of UI payments over a three year period. In comparison, those who did not take training could receive at most 52 payments over a two year period.

The Benefits of Increased Flexibility

An attractive feature of the REAP program is that it would give each state wide discretion in selecting the types of services to provide and the mechanisms for delivering those services. As discussed above, vocational training is the only one of the three basic types of assistance that has received a substantial increase in resources. But training is relatively expensive, and is not obviously superior to other options. Thus, the REAP program has the potential to give states the flexibility needed to develop a more balanced approach.

In addition, state flexibility can provide the information needed to spot flaws and rapidly improve program design. Recently, the US Department of Labor and Congress have recognized that restrictions, such as severely penalizing EDWAA service providers who spend less than half their funds on vocational training, have been counter-productive. Similarly, there is growing recognition that EDWAA's emphasis on short duration training

and quick placement may have induced creaming and reduced long-run gains.⁴ But it has taken considerable time to act on this knowledge.

Measuring the Benefits of REAP

Giving wide discretion to the states would encourage considerable experimentation and provide opportunities to judge the value of treatments that vary considerably from those currently in widespread use. But the promise of learning a great deal about how best to aid the long-term unemployed would only come about if a concerted effort was made to critically evaluate the results of each state's efforts.

I have long been puzzled by the claim states act as "laboratories" for social experimentation. What distinguishes scientific inquiry is demonstrating at the outset that an experiment can adequately test a stated set of hypotheses, and then carefully collecting the data required to perform the specified test. In distinct contrast, states rarely adopt procedures to test the effectiveness of alternative treatments, or even collect the data needed to measure the effectiveness of the programs adopted.

In a period where states are scrambling for funds to keep programs operating it is understandable that evaluation would be considered a frill they could not afford. But given the substantial funding earmarked for REAP, it would be tragic to ignore evaluation of the new efforts.

A low-cost option would be to have the US-DOL evaluate the effectiveness of a range of REAP programs using administrative data. Evaluations of REAP using administrative data are likely to be exceptionally effective. First, REAP is aimed at workers who have registered for UI, and in most cases, ES services. Thus, considerable administrative data will be available for workers in this group who take advantage of REAP programs, and of great importance, a suitable comparison group of workers who do not use REAP. Second, the REAP program is targeted on workers with considerable work experience. This makes it likely that random assignment is not needed to control for selectivity bias that has plagued studies of workers with spotty work records.⁵

⁴ See for example, "A Comparison of the Effectiveness of JTPA Training Programs Administered under Tuition vs. Performance-based Contracts" This recent DOL report prepared by Arnold Katz of the University of Pittsburgh and Robin Rogers of the Pittsburgh Private Industry Council (PIC) suggests stress on short-run "success" reduces long-run gains.

⁵ Despite the high likelihood of success whether or not evaluations without random assignment produce unbiased results should be tested by directly comparing results using non-experimental methods with those derived from a randomly selected comparison group.

Encouraging Innovative Programs and State Evaluations

Consideration also should be given to using REAP funds to improve the capacity of state's to evaluate REAP and other programs. Even more worthwhile would be setting aside a modest amount of REAP funds for use by the US-DOL to induce states to evaluate innovative programs. Although there is likely to be a great deal of natural variation, no state may be willing to risk substantial sums on a potentially effective, but unproven, approach.

One promising approach is the use of wage subsidies. An unintended side-affect of UI benefit programs is that they create disincentives to return to work. Such disincentives would be unimportant if workers ultimately were recalled or there were so few jobs available during a deep recession that job search was fruitless. But available evidence suggests that countering disincentive effects would be worthwhile.

The Illinois Bonus Experiment demonstrated that a re-employment bonus was highly cost-effective during the period when EB and FSC were in place, (but not cost-effective after those programs ended). Unfortunately, the evidence applies only to a period when the recovery from the recessions of the early 1980's was well underway. Thus, it is possible that the returns to job search would be considerably lower in the early and middle stages of a recession. The evidence cited above showing that there was considerable hiring in Pittsburgh during one of the worst declines in history, however, suggests the returns to job search, although reduced, would be sufficient to justify encouraging search.

Moreover, my ES research with Arnold Katz showed that the long-term unemployed who used the ES initially took relatively low paying jobs, but their earnings grew substantially over the next several years. If workers only focus on the wage at hiring and fail to recognize that the quicker they return to work the quicker their earnings will begin to grow, they will be particularly unlikely to accept available jobs. The fact that initial earnings often are only slightly above the level of UI benefits accentuates the possibility that UI will induce workers to act counter to their own long-run interests.

Compounding the problem is the possibility that long-duration unemployment has a "scaring" effect. Several studies suggest that employers are reluctant to hire workers who have experienced long-duration of unemployment, or alternatively joblessness itself depresses workers to the point the can not effectively search for work.

Perhaps the best evidence in favor of wage subsidies is that, based on the Pennsylvania dislocated worker study cited above, a subsidy paying half the difference between actual and prior earnings up to 75 percent of prior earnings would substantially increase the earnings of high-tenure dislocated workers. As an example of how the lack of solid information can lead to poor policy choices, the only wage subsidy demonstration in the US was turned down by Pennsylvania officials because they did not believe earnings losses of

the long-term unemployed were large enough to make responding to the above subsidy worthwhile.

Summary and Conclusions

The new bill does an admirable job in reaching the limits of what government can do to solve the most fundamental problems facing the long-term unemployed. By adjusting the EB trigger and establishing REAP it sets out a forward looking program that holds the promise of permanently reestablishing the balance between costs borne by the unemployed and those borne by society at large, as well as the balance among the three basic types of assistance.

Given the evidence that providing adjustment services to the long-term unemployed is cost-effective the emphasis on increasing funding is warranted. It is refreshing to see a proposal based on the premise government programs can have benefits greater than its costs, instead of judging a program purely on its cost.

Further, establishing a new program that gives states a great deal of flexibility will complement existing programs. Experience with EDWAA suggests that this program contains counter-productive restrictions that only now are being corrected.

Research also suggests that the traditional triad of cash payments, job search assistance, and retraining should be supplemented with wage subsidies or bonuses that encourage a rapid return to work. I strongly recommend setting aside funds to encourage introduction of wage subsidies and other innovative programs.

But one of my favorite adages is: "Before advocating any program imagine what would happen if it was implemented by your worst enemy". Thus, in my view the linchpin of the entire effort is insuring that programs developed with REAP funds are adequately evaluated.

We have plenty of evidence that good intentions are not enough. Program designers are fallible and, in the absence of solid evidence, too frequently base decisions on erroneous assumptions. Only by accurately measuring the effectiveness of various programs can we insure that the interests of the long-term unemployed will be adequately served.

Thus, I most strongly urge that the US Department of Labor be given the mandate and resources needed to evaluate the range of services available to the long-term unemployed. We now have the technical means to accurately carry out such evaluations at a minute fraction of the program cost.

I, therefore, look forward to a future where this committee will lift the fog of misunderstanding over the value of service to the long-term unemployed at least as effectively as other committees have lifted the fog of war.

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Summary

The new UI bill does an excellent job of providing the means to reestablish the balance between costs borne by unemployed workers and those borne by society at large, as well as the balance among the three basic types of assistance for the long-term unemployed: cash payments, job search assistance, and retraining. In addition, the bill provides the flexibility needed to develop new, highly effective, forms of assistance. But unless steps are taken to insure that states receive feedback on the effectiveness of various types of assistance the bill could fail to establish programs that would deliver adequate services to the long-term unemployed.

Reestablishing the balance between costs borne by the unemployed versus costs borne by society is appropriate. The availability of unemployment compensation and supportive services to aid the long-term unemployed seriously deteriorated over the past ten years. During this same period the substantial restructuring of major US industries increased the need for such assistance.

Through the REAP program the bill provides the means to restructure key institutions to effectively deal with future problems. This too is highly appropriate. Restructuring of the US economy will continue to cause major dislocations in response to the decline in domestic defense spending, as well as changes in international competition, such as those stemming from the North American Free Trade Agreement (NAFTA).

Another positive aspect of the bill is that it gives states wide discretion in implementing effective programs. There is growing recognition that federal restrictions on state and local programs were counter-productive. But more could be done to encourage innovation. In addition to returning a portion of the UI payroll tax to the states, I suggest creating a separate fund to be distributed by the US Department of Labor for use by states to try-out, potentially highly effective, but unproven strategies. In particular, wage subsidies might dramatically reduce the costs of dislocation borne by workers and government. Yet, in the absence of federal assistance, states are unlikely to bear the risk of using new approaches.

The one glaring omission from this bill, however, is that it does nothing to insure that states competently monitor program effectiveness, and then overtime, modify the programs to better meet the needs of the long-term unemployed. Providing adequate feedback is a key aspect of effective policy design, but unfortunately, often overlooked. As a researcher I am acutely aware of the lack of solid information needed to refine policy instruments, but also am struck by the growth of our technical ability to provide reliable information at a tiny fraction of the total cost of these programs. Thus, my most important recommendation is for the US Department of Labor to be given the mandate and the resources needed to rigorously evaluate services under REAP and other programs to aid the long-term unemployed.