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Employment Research

OCTOBER 2000

New Directions in
Reemployment Policy

The Economics of Medicare Reform

2000 Dissertation Award Winners

New Books

Vol. 7, No. 3

Employment Research is now published quarterly by the W.E. Upjohn Institute for Employment Research. Issues will appear in January, April, July, and October.

The Institute is a nonprofit research organization devoted to finding and promoting solutions to employment-related problems at the national, state, and local level. The Institute is an activity of the W.E. Upjohn Unemployment Trustee Corporation, which was established in 1932 to administer a fund set aside by the late Dr. W.E. Upjohn, founder of the Upjohn Company, to conduct research on the causes and effects of unemployment and seek measures for the alleviation of the hardships suffered by the unemployed.

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New Directions in Reemployment Policy

Editor's Note: This is the sixth in a series of Employment Research articles on "Research Questions for the New Millennium." The purpose of the series is to help define the research questions that can inform policy and improve employment programs in the future.

Reemployment policy in the United States can be dated to the passage in 1933 of the Wagner-Peyser Act, which established the U.S. Employment Service (ES). Throughout its history, the ES has served as a free public labor exchange, registering job seekers, taking job orders from employers, and matching workers with job vacancies. Since the establishment of unemployment insurance (UI) in 1935, the ES has also administered the UI work test, which attempts to ensure that UI recipients are able to work, available for work, and seeking work. Although the ES has had other functions over the years, these two have been consistent.

The Changing Role of the Employment Service

Like UI, the ES is a federal-state system; that is, each state administers its own ES program, but the U.S. Department of Labor funds and oversees the state programs. Accordingly, the role of the ES has changed as the emphasis of federal reemployment policy has changed. This evolution of the ES's role

is summarized in Table 1, which lists relevant major federal legislation and the implications of each act.

Until the 1960s, reemployment policy in the United States emphasized job placement and assumed that unemployed workers were job-ready and merely needed to be matched to an employer. During the 1960s, however, the Manpower Development and Training Act and the Economic Opportunity Act shifted emphasis away from job placement and toward "second-chance" training for workers who either were poorly served by the conventional system of public education or who were dislocated as a result of structural economic change. The role of the ES in this shift was at first substantial, but that role dwindled with the adoption of the Comprehensive Employment and Training Act (CETA) in 1973. Under CETA, training services were administered locally, with the result, in the view of many, that reemployment services became fragmented. The diminished role of the ES continued through the 1980s and into the 1990s following adoption of the Job Training Partnership Act (JTPA) in 1982.

During the 1980s there was much dissatisfaction with the ES, and questions were raised about its role and importance. Also during the 1980s, however, convincing research became available

Table 1 Employment and Training Legislation and the Changing Role of the Employment Service

Legislation	Implications for Policy and ES
Wagner-Peyser Act (1933)	Creation of U.S. Employment Service; emphasis on public labor exchange/ placement services.
Social Security Act, Title III (1935)	Creation of the Unemployment Insurance (UI) system; ES to administer the UI work test.
Area Redevelopment Act (1961)	ES established training programs in depressed areas; increased collection of labor market information.
Manpower Development and Training Act (1962)	Further involvement of ES in training programs; reduced emphasis on traditional placement services.
Economic Opportunity Act (1964)	ES provides outreach, screening, referral for disadvantaged worker programs.
Comprehensive Employment and Training Act (1973)	Local provision of reemployment services as well as by ES; fragmentation of reemployment services.
Job Training Partnership Act (1982)	Continued local control of delivery of reemployment services.
Worker Profiling and Reemployment Services (1993)	ES administers reemployment services under UI profiling; return of emphasis on public labor exchange/ placement services.
Workforce Investment Act (1998)	ES becomes locus of One-Stop Centers.

Source: Haber and Murray (1966); Bendick (1989); Balducci, Johnson, and Gritz (1995); Fagnoni (2000).

showing that existing government training programs fell short of their hoped-for results (LaLonde 1995). Moreover, a series of demonstrations using randomized trials suggested the effectiveness of relatively inexpensive reemployment services (job search workshops, interview and resume preparation classes, and other assistance) in helping unemployed workers (Meyer 1995). As a result, the former optimism over second-chance training was replaced by an emphasis on placing workers in jobs. In short, the sentiment for "training first" was replaced by a growing belief in "work first."

The new emphasis on "work first" was embodied in amendments to the

Social Security Act that established the Worker Profiling and Reemployment Services initiative in 1993. Under profiling, UI claimants who are likely to exhaust their UI benefits are required to attend job search assistance workshops conducted by the ES or risk losing their UI benefits (Corson and Decker 2000).

The Workforce Investment Act

The new emphasis on "work first" is even clearer in the Workforce Investment Act of 1998 (WIA), which embodies two main changes in reemployment policy. First, it requires that states provide most federally funded employment and train-

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ing services through a system of One-Stop Centers, which provide all reemployment services (or information about and referral to such services) at a single location. The intent of One-Stop Centers is to offer an attractive, logically organized office that directs any job seeker to information, assistance, or programs needed to gain employment. Moreover, One-Stop Centers encourage coordination of services by collecting the day-to-day operations of various reemployment programs under a single manager.

Second, WIA replaces the JTPA programs for economically disadvantaged and dislocated workers with programs for adults, dislocated workers, and youth that

deemphasize the differences among the groups needing assistance. Specifically, WIA provides three levels of services: core (including basic services such as job search assistance), intensive (including services such as assessment that require staff assistance), and training (for eligible workers). As part of this change, the Private Industry Councils that existed under JTPA are replaced with Workforce Investment Boards. This is significant, because Private Industry Councils were concerned mainly with the provision of training under JTPA, but Workforce Investment Boards have responsibility in principle for overseeing all reemployment services and government-funded training in their region. (In practice, further legislation will be required before Workforce Investment Boards are able to influence programs like vocational rehabilitation and vocational-technical education.)

The idea of "one-stop" reemployment services is hardly new: Haber and Murray referred to it in their 1966 volume on UI, and a year later, the Manpower Administration issued a memorandum on "Improving Communication and Service to the Public" that discussed integrated delivery of human services at central locations. Accordingly, WIA must be viewed as an attempt to bring about what has long been viewed as desirable: the centralization of information and other reemployment services to promote employment.

The Employment Service in Recent Years

The traditional role of the ES as a free public employment agency has involved five main services: job referral, counseling and assessment (including aptitude and interest testing), job development, other job search assistance services, and referral to training. Over 40 percent of ES applicants received job referrals in 1994 and 1998 (Table 2), and a growing percentage of ES applicants have been receiving "other" services, which include job search workshops, job-finding clubs, and classes in job-finding skills. These latter have increased in importance since worker

Table 2 Employment Service Activity Measures, Program Years 1994 and 1998

Measure	1994	1998
Total applicants (000s)	18,810	17,288
Receipt of services (as % of total)		
Received any service	63.7	62.8
Referred to employment	43.7	40.5
Counseling/assessment provided	na	10.8
Job search activities	21.3	36.0
Referred to training	2.2	2.4
Applicants by type (as % of total)		
Eligible UI claimants	40.7	37.1
Veterans	12.2	10.2
Economically disadvantaged	15.7	14.5
Persons with disabilities	na	2.0
Applicants placed (000s)	2,682	1,886
(as % of total applicants)	14.3	10.9
Applicants entering employment (000s)	3,358	3,265
(as % of total applicants)	17.9	18.9
Job orders received (000s)	2,838	2,897

Sources: U.S. Employment Service Annual Report. Washington, D.C.: Office of Workforce Security, U.S. Employment Service, U.S. Department of Labor (reports for program years 1994 and 1998).

profiling started in 1994. Only about 11 percent of ES applicants received counseling and assessment in 1998, and just over 2 percent received referral to training. This last, presumably, will increase under WIA, which gives the ES greater access to the training system. (Statistics do not exist on the frequency of job development, which is similar to job referral except that an ES interviewer contacts one or more employers known to hire workers with the applicant's skills.)

Table 2 also shows the composition of ES applicants: roughly 40 percent are UI claimants, over 10 percent are veterans (reflecting administration of special programs for veterans by the ES), and about 15 percent are economically disadvantaged. In 1998, 2 percent had a disability. It is too early to know whether or how this composition will change as WIA takes hold and One-Stop Centers proliferate.

Finally, 11–14 percent of ES applicants are placed in jobs by the ES, and

18–19 percent of ES applicants enter employment within 90 days of registering with the ES. These figures might be interpreted to imply that ES applicants are difficult to place. However, Table 2 also shows that the ES may be hampered in placing applicants by a lack of job orders: the number of job orders received by the ES is usually only slightly greater than the number of workers placed.

Issues for Policy and Research

The WIA points government efforts to assist unemployment workers in a new direction, and its success will turn on whether the assumptions underlying its adoption are correct. The above discussion suggests the importance of the following research questions.

1. Is WIA's "work first" approach effective? WIA has been subject to two types of criticism. One is that WIA, in emphasizing job placement over

training, may limit the access to training of workers for whom it would be effective (Emsellem 2000). Another is that effective training is expensive, and WIA, rather than increasing the total resources available for employment and training, amounts to a downsizing of the reemployment system (Bartik and Hollenbeck 2000). An essential question for reemployment policy, then, remains whether programs that encourage employment (or rapid reemployment, even in a low-wage job) are better for workers and society in the long run than are government training programs.

2. What is the value of various reemployment services? Of the services traditionally provided by the ES—job referral, counseling and assessment, job development, and other (intensive) services—only job referral and intensive services have been evaluated comprehensively. However, evidence on the effectiveness of referrals has been criticized because, unlike the most convincing evidence on employment and training policies, it has not been based on randomized trials. Also, the intrinsic value of intensive job search assistance remains unclear. Experimental research suggests that job search workshops reduce unemployment duration by imposing an additional requirement on UI recipients—i.e., to report for services—rather than by enhancing workers' job search abilities per se (Balducchi, Johnson, and Gritz 1997). In order for One-Stop Centers to function effectively, knowledge of what services work best for various groups of workers is essential.

3. Little is known about the value of universal access to information of the kind available through America's Job Bank, the computerized national labor exchange. Arguments for the public subsidy and provision of information on jobs turn on the value of such information and the failure of private markets to generate enough. Do the

arguments in favor of a public labor exchange—e.g., those of Bendick (1989)—continue to hold in a day of relatively easy Internet access?

4. How is the performance of reemployment services best gauged? The performance measures set out in WIA have been criticized by economists for their focus on easily measurable outcomes that are weakly related to the value of reemployment services and that may create incentives for One-Stop Centers to assist workers least in need of services (that is, to "cream"). For example, emphasis on the *entered-employment rate*—the proportion of applicants who enter employment within 90 days—can be expected to induce One-Stop Centers to focus on workers who might easily find jobs on their own rather than on workers requiring greater effort to place (Jacobson 1999). There is much need for research into performance measures that are easily obtained and that also gauge the benefits and costs of services provided.

The WIA brings reemployment policy closer to the focus on job placement and "work first" that it had before the emergence of federally funded training programs in the 1960s, but with a novel twist. While attempting to retain what many view as the benefits of a reemployment system that receives substantial direction from local community interests, WIA promises to centralize the locus of information, training, and other services for unemployed workers in One-Stop Centers. Evaluating whether the promise of WIA is realized and learning what can be done to improve continuously the reemployment system will require data and innovative research that will occupy policymakers and researchers for years to come.

Stephen A. Woodbury is a Professor of Economics at Michigan State University and a Senior Economist at the Upjohn Institute.

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Andrew J. Rettenmaier and Thomas R. Saving

The Economics of Medicare Reform

Around the globe, entitlement programs for the elderly are at a crossroads. Without fundamental reform, the rapidly approaching retirement of the post war baby-boom generation will cause another boom in the form of higher tax rates on workers or a bust in the form of reduced benefits to retirees. As in many other developed countries, the United States' elderly entitlements—Medicare and Social Security—are supported by transfers from the young to the old. The question is, how will the United States and other countries prepare for the retirement of the baby boom? Because the programs are financed by taxes, the question is one of crucial importance in terms of public policy.

Reforming Medicare and Social Security go hand in hand. The solutions to Social Security's financing problems are applicable to those of Medicare. Working within the context of transfer-payment financing, the possible solutions involve tax hikes, benefit reductions, reductions in other federal programs, or combinations of all three. Left unchecked, Medicare and Social Security spending will consume 11.7 percent of the nation's gross domestic product by 2030, up 66 percent from their current share. Paying for these elderly entitlements using tax revenues will require a tax rate approaching 30 percent of taxable earnings. Alternatively, balancing the budget at current tax rates would require substantial future benefit cuts.

For some time now, the prepayment of all or some of future retirement Social Security benefits has been discussed in policy circles as an answer to the problems inherent in transfer-payment financing, but regardless of the route taken, one generation or several generations will

bear the burden of the system's implicit debt. Future benefit reductions place the burden on future retirees, who are today's workers. Increasing taxes in future years places the burden on future taxpayers who are today's young. Prepayment places the burden on current workers. So, in some ways, benefit cuts in the future and prepayment are equivalent. Further, because transfer-payment financing of retirement expenditures suppresses saving and, as a result, reduces the capital stock, current workers have lower wages than they would have had with a funded program.

In our book *The Economics of Medicare Reform*, prepayment of retirement health insurance is studied as part of a sweeping proposal to reform the Medicare program. Prepayment of elderly consumption has several advantages over the current unfunded system, the main one being a higher capital stock and higher national income. In addition, while prepayment requires current workers to pay for their own retirement and that of current retirees, it also releases subsequent generations from onerous tax rates.

In contrast to Social Security, which is an unrestricted cash transfer, Medicare provides health insurance coverage. The cost of providing that coverage has grown at rates that have far outpaced the growth in other expenditures. Between 1970 and 1998, real Medicare expenditures per enrollee grew at a rate of 4.8 percent, while real Social Security benefits grew at a rate of 1.7 percent, so an answer to the Medicare funding problems must address both the population bulge and the size of and growth in real expenditures. In our book, we also analyze the benefits of converting Medicare's two-part insurance package

2000 Dissertation Award Winners

For the sixth year, the W.E. Upjohn Institute has awarded a prize for the best Ph.D. dissertation on an employment-related topic. The winner of the 2000 Dissertation Award is Luojia Hu, of Princeton University, for "Four Essays in Labor Economics and Microeconomics." Hu's dissertation advisor was Henry Farber. Two dissertations were chosen for honorable mentions: Sean May of Massachusetts Institute of Technology for "Essays on the Economics of Crime and Econometric Methodology," and Darren Lubotsky of the University of California, Berkeley, for "Essays in Applied Labor Economics: Immigrant Earnings and Welfare Reform." May's dissertation advisor was Joshua Angrist, and Lubotsky's advisor was David Card.

Hu's dissertation explores hiring decisions and compensation at large firms; the use of means-tested transfer programs by immigrants and their descendants; earnings dynamics using a censored dynamic panel data model; and methods to use such censored models with general predetermined variables.

May's dissertation investigates a possible causal link between wage rates and crime rates; estimates the employment consequences of being a crime victim; and explores an inference problem involving bootstrap methods for Generalized Method of Moments estimators. Lubotsky's dissertation studies immigrant earnings assimilation using longitudinal data, and then analyzes the effects of the elimination of Michigan's General Assistance program in 1991.

to a single higher-deductible policy for future retirees. This type of health coverage makes consumers care what health care costs and can play a major role in restoring competition to the industry. The higher-deductible policy will reduce the cost of the transition to a prepaid system and may well affect expenditure growth.

The strain that Medicare has placed (and will place) on government finances was not lost on those who passed the legislation. Even before its passage, powerful members of Congress predicted that the program would require escalating tax rates and increases in the taxable maximum. Interestingly, reviewing the debates that led up to Medicare's passage also remind us that many of the proposals currently being discussed—including choice, means testing, vouchers, and even prepayment—have historical antecedents.

Unfortunately, we cannot go back to 1965 and choose among the options that were on the table then. The institution of Medicare in 1965 was a boon for members of the original retired generation, who immediately received benefits without paying any taxes. Today, the current working generation must recognize the system's debt in developing a means to finance the program.

We evaluated several transition scenarios that differed by the rate-of-return assumptions and by the benefit package

that is prepaid. The common features of the scenarios included moving all baby boomers into the prepaid system of individual retirement health insurance accounts and requiring all individuals to contribute to an insurance account that pays for their medical care during retirement. In the simplest construction, all individuals of a given age engage in a mutual insurance compact that begins when they enter the labor force and lasts through retirement. Contribution rates to the insurance accounts are periodically updated as more information about future health care expenditures is known.

By investing in private accounts, workers can prepay their retirement health insurance at rates that are lower than the implied Medicare tax. Any differential between the current implied Medicare taxes and the cost of prepayment goes toward funding the older cohorts—those born before 1946—who remain in the conventional Medicare system. The younger cohorts' contributions are also used to subsidize the prepayment of most of the baby boomers' retirement health care. A final common feature in each simulated transition is the imposition of a transitional tax to cover its cost.

One of the transition paths we analyzed involves replacing the current Medicare package in full. Figure 1

shows the simulation results for the cost of making the transition to a prepaid system versus the cost of retaining the current pay-as-you-go financing. By the 16th year, workers pay less in taxes and contributions to their retirement health insurance accounts than they would in taxes if the current pay-as-you-go Medicare financing system is retained. In all future years, workers pay lower taxes than would be needed to finance Medicare on a pay-as-you-go basis. As Medicare is replaced with fully funded real investment, the nation's capital stock will increase and provide the resources necessary to fund the retirement medical care of the baby boomers and protect the rights of older generations to retirement medical care.

Conference on Nonstandard Work Arrangements

On August 25–26, 2000, the Institute, the Japan Foundation, and Japan Women's University cosponsored a conference featuring international comparisons of nonstandard work arrangements such as part-time, temporary, and contract employment. Twelve papers were presented by researchers from Japan, Europe, and the United States, including Peter Auer and Sandrine Cazes; Françoise Carré; Naomi Cassirer; Inmaculada Cebrián, Gloria Moreno, Manuela Samek, Renata Semenza, and Luis Toharia; Colette Fagan, and Kevin Ward; Siv Gustafsson, Eiko Kenjoh, and Cécile Wetzels; Edeltraud Hoffmann and Ulrich Walwei; Susan Houseman and Machiko Osawa; Arne L. Kalleberg and Jeremy Reynolds; Noriaki Kojima and Keiko Fujikawa; Nobuko Nagase; and Isabelle Schömann and Klaus Schömann. The full text of these papers is on the Institute's Web site: <http://www.upjohninst.org>.

Figure 1 Transition Path to Prepaid Medicare

New Books from the Upjohn Institute

The Economics of Medicare Reform

Andrew J. Rettenmaier and
Thomas R. Saving

Since 1965, Medicare has offered older Americans access to health care in a way that neither drained their life savings nor put undue financial stress upon their children. Today, however, despite a flourishing economy, Medicare is in danger of going broke as fewer workers pay for the health benefits of a growing aged population.

Andrew J.

Rettenmaier and Thomas R. Saving, after detailing the reasons for Medicare's financial troubles, present their cohort-based financing plan for Medicare,

which represents a fundamental departure from the generation-transfer method currently used.

The system they propose requires each age cohort (all individuals born between January 1 and December 31 in any given year) to insure itself against retirement medical expenses. Workers in each cohort contribute to accounts that would, by the time of their retirement, contain a large enough sum to pay for their cohort's remaining lifetime health care expenditures.

"By moving to prepaid financing," say Rettenmaier and Saving, "we remove the disincentives to invest, and the nation will experience an increase in its capital stock and income. It is this increase in the capital stock and national income that provides the additional resources available to pay off most, but not all, of the current system's unfunded liability.

"There is no free lunch," they conclude, "but there is a considerably cheaper lunch that is of better quality than the one we are currently committed to buying."

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Employee Benefits and Labor Markets in Canada and the United States

William T. Alpert and Stephen A. Woodbury, editors

This collection includes 14 chapters that highlight the principle features and related policy issues of employee benefits including retirement income, health care, unemployment insurance, workers' compensation, and life insurance.

Following the editors' introduction and an overview chapter, the book is divided into four parts. Part I deals with labor supply, specifically the relationship between employee

benefits and work. Part II examines the relationship between employee benefits and the demand for labor. Part III includes chapters that consider the implications of employee benefits for worker turnover, wages and equity. Part IV focuses on pensions and public policy toward retirement income.

Contributors include **Sherwin Rosen, Charles Michalopoulos, Philip K. Robins, Paul Fronstin, Eileen Trzcinski, William T. Alpert, Jonathan Gruber, Masanori Hashimoto, Dan A. Black, Craig A. Olson, Janet Hunt-McCool, Thomas J. McCool, Avi Door, Daniel J. Slottje, Stephen A. Woodbury, Rod W. Anderson, Morley Gunderson, Douglas Hyatt, James E. Pesando, Stuart Dorsey, John A. Turner, and Patricia B. Reagan.**

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Changes in Income Inequality within U.S. Metropolitan Areas

Janice F. Madden

Madden uses data on the 182 largest MSAs to study income redistribution during the 1980s. These data allow her to relate characteristics of metropolitan economies with significant changes in income inequality and poverty.

She offers statistical analyses on the

relationships between changes during the 1980s in income inequality, wage inequality, and poverty rates in MSAs and what she calls the three "likely suspects," factors that are

most likely related to changes in income inequality in metropolitan areas. Those factors are demographics, the labor market, and geographic structure (including the increased locational isolation based on income or race).

This study is important, says Madden, because "knowledge of the circumstances surrounding changes in metropolitan income inequality is essential to our understanding of how the larger economy affects income distributions. We cannot respond with economic or social policies (or even decide not to respond) to changes in income inequality or other metropolitan economic issues without such knowledge."

Overall, this book will be of great interest to anyone concerned with income and wage inequality, or metropolitan labor markets.

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