Succeeding in the Global Economy

An Adjustment Assistance Program for American Workers

White Paper

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Like the rest of the U.S. economy, the U.S. labor market is extremely dynamic. Jobs appear and disappear, and companies start up and shut down, at amazing rates. In 2007, for example, private-sector employment expanded by about 900,000 jobs. But this net increase masked the far more dramatic shifts below the surface—the economy created about 30 million jobs, while losing roughly 29 million. What that means is that, based on an average of four 40-hour work weeks a month, about 25,000 jobs are destroyed and created every hour that America is open for business.

Economic change and adjustment is essential to the health of the U.S. economy. Without all of this reallocation, average living standards would be harmed not helped. That said, adjustment presents very real costs to American workers, communities, and firms. There is considerable evidence that involuntary job loss can be costly. About two-thirds of displaced workers find new full-time jobs—but at an average wage loss of 13-17%. And this average disguises a wide range of experiences: 36% gained re-employment at or above previous earnings, whereas 25% suffered earnings losses of 30% or more.

Unemployed workers face major challenges: supporting themselves and their families when they no longer have earnings; searching and training for new jobs; and preserving earnings capacity in these new jobs. Not surprisingly, many American workers feel anxious—about change and about their paychecks. Their concerns are real, widespread, and legitimate. In our earlier report, we highlighted the structural problems we see with our current adjustment-assistance programs and the need for fundamental reform.¹

While international trade receives most of the attention in the current political debate, it is only one—and, indeed, not the most

“In layoffs of 50 or more people between 1996 and 2004, less than 3% were attributable to import competition or overseas relocation.”

- Bureau of Labor Statistics


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important—of the forces driving this dynamic reallocation of people, capital, and ideas to emerging business opportunities. Technological change, seasonal business patterns, shifting customer tastes, and many other forces are also at work. The data on this point are very clear. For example, survey data from the Bureau of Labor Statistics show that in layoffs of 50 or more people between 1996 and 2004, less than 3% were attributable to import competition or overseas relocation. In 2007, the BLS counted 931,053 such “mass layoffs” in the U.S. economy, of which only 1.2%—11,526 in total—were attributed to overseas relocation of the work. Many research studies using different data have reached the same conclusion: the large majority of U.S. worker separations are driven by forces other than international trade.  

We regard current U.S. labor-market programs as well intentioned but, because of their design, inadequate to cope with these widening labor-market pressures and the resulting drift towards more protectionist policies that these pressures create. As currently structured, U.S. labor-market supports do not adequately help workers cope with the challenges faced in today’s economy. Even within their limited reach, these programs do not perform well or efficiently.

That is not surprising, because current programs were designed for another age. Unemployment Insurance (UI) was introduced in the early 1930s and has not changed in any fundamental way since then. UI benefits were designed to supplement a worker’s salary until rehired by his or her previous employer. Today, the challenges facing unemployed workers are often much more involved: matching with a new employer, often in a new industry; upgrading or learning new skills; and coping with lost benefits, especially health care.

Trade Adjustment Assistance (TAA) faces similar problems. Created in the early 1960s and designed to supplement UI, TAA was intended to assist workers displaced by stronger competition from imports. It was expanded in 1993 to account for shifts in production from the United States to Mexico with implementation of the North American Free Trade Agreement (NAFTA).

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3 Kletzer and Rosen, 2006; M. Coven, Introduction to Unemployment Insurance, (November 10, 2003 (Center on Budget Policies and Priorities). The federal tax that provides the main source of funding for UI is set by the Federal Unemployment Tax Act (“FUTA”), and is equal to 0.8 percent of the first $7,000 paid annually to each employee. Id. Note that, as we discussed in our earlier report with respect to the Federal Income Compensation ACT tax that funds Social Security, the tax that funds UI is extraordinarily regressive; since most workers earn more than $7,000 per year, most workers are effectively paying the same flat tax of $56 per year regardless of income. The percentage of overall wages paid in FUTA taxes on behalf of high-wage workers is therefore much lower than for low-wage workers.

4 Under the newly created NAFTA Transitional Adjustment Assistance program, eligibility no longer required a showing that an employee had been laid off due to increased levels of import competition. Rather, the employer needed solely to show that there had been a shift in production from the employer’s
Today, however, rather than facing a one-time adjustment to new levels of import competition, firms and workers face continual adjustment as new technologies and competitors, both domestic and foreign, make existing capital equipment and skills obsolete. With the exception of a small wage-loss insurance program for workers over 50 that is difficult to qualify for, TAA offers adjustment assistance solely to workers who seek retraining, rather than assisting workers with the manifold adjustment challenges they face today. Most workers in transition find TAA’s current benefits inadequate or inappropriate for their needs: in recent years, less than a quarter of certified workers actually took TAA benefits.

The irony is that, despite the relatively small role that international trade plays in U.S. labor-market dislocations, TAA tends to dominate discussions of how government policy can mitigate the human costs of adjustment. Indeed, all TAA petitions filed in 2007 covered a total of just 93,903 workers—fewer jobs than were created or lost on an average day that year in the U.S. economy.\(^5\)

Given the breadth of forces driving change in the U.S. labor market, what is clearly needed is a broader, more-responsive safety net that assists workers in transition regardless of the reason they find themselves moving from one job to another. Our purpose in this white paper is to propose a set of expanded, integrated policies that can fundamentally reshape U.S. labor-market policy. Instead of simply renewing TAA in some form, we propose that Congress implement our alternative: the Adjustment Assistance Program (AAP). In two basic ways, our AAP would greatly improve public supports for American workers.

One way is funding. At an estimated annual cost of $22 billion, the AAP would commit more than twenty times the resources currently spent on TAA.

The other is structure. In our previous report, we recommended creating a broader set of benefits for workers that would combine the best elements of UI, TAA, and training programs authorized by the Workforce Investment Act (WIA) with a single integrated approach to adjustment and training designed to return individuals to the workforce as quickly as possible.\(^6\)

The merits of combining those programs into a single integrated approach to adjustment and training are twofold. One is that, rather than a series of

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uncoordinated approaches that only indirectly help American workers, the AAP would offer a system to all workers to facilitate their return to the workforce with skills capable of ensuring continuing employment.\(^7\) The other is cost savings that would flow from eliminating separate qualifications and administrative staff for multiple programs, rather than a single integrated approach.

Toward that end, our AAP builds on the basic structure of WIA. The WIA “one-stop” approach comes closest to providing a menu of supports for workers. It also builds in local participation. The strategic planning process the WIA requires ensures that local authorities, who know the strengths and weaknesses of their own education and training programs, assume both responsibility and accountability for maximizing the return on taxpayer dollars in pursuit of a highly trained and flexible American workforce prepared to succeed in the global economy.

**Our Adjustment Assistance Program would include the following main elements, which are detailed in the remainder of this report.**

- a wage-loss insurance program for workers 45 and older, to supplement their income when they take employment at a lower paying job;
- continued health insurance coverage while workers remain eligible for unemployment insurance;
- allowing workers in transition to supplement their unemployment benefits by withdrawing, without penalty, savings they have previously accumulated in tax-advantaged vehicles such as individual retirement accounts;
- expanded eligibility for current federal training programs, combined with the expansion of tax preferences designed to encourage ongoing skills acquisition and life-long learning;
- a more progressive approach to funding support for American workers that would pay for the above four main AAP elements with a flat tax of 1.32% levied on all wages.

“The AAP would offer a system to all workers to facilitate their return to the workforce with skills capable of ensuring continuing employment.”

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\(^7\) One indication of the lack of nexus between current training programs and job-market requirements is the much lower uptake rates for TAA and WIA programs than for basic UI. In essence, workers in transition do not find sufficient value in available training programs to apply. See the discussion by Howard Rosen in, “Trade Adjustment Assistance: The More We Change, The More It Stays the Same,” in C. Fred Bergsten and the World Economy, 2006, Washington, D.C.: Institute for International Economics.
Section 1: Providing Wage-Loss Insurance

Workers are exposed to the risk of losses of specific human capital, because unemployment can lead to new jobs at lower wages than before. We propose mitigating this risk by using the expanded UI revenue described below to implement a new wage-loss insurance program that would replace 50% of eligible workers’ lost wages for up to two years. The net annual cost of this new program would be approximately $7 billion.

The Rationale for Wage-Loss Insurance

People’s earnings often reflect returns both to “general” human capital, which can be applied across many jobs, and also returns to “specific” human capital, which accumulates in particular positions and is not easily transferred across jobs.

In principle, diversification is the appropriate way to deal with many types of risk. But in practice, it can be difficult for a person to diversify the risk of his or her specific human capital. The risks associated with specific skills that could fluctuate in value are not readily insurable: individuals cannot easily issue equity against their future earnings, and insurance firms might worry about the moral hazard of such insurance inducing lower worker effort.

This suggests a potential role for government: which is wage-loss insurance where the government agrees to at least partly compensate earnings declines realized after unemployment spells. Wage-loss insurance can reduce the risk associated with specific human capital—and thereby give workers greater peace of mind. Moreover, it can also benefit society by allowing workers to take riskier but higher-output jobs that pay higher wages.8

Some have voiced concerns about possible moral-hazard implications of wage-loss insurance. One is that it would encourage the unemployed to take low wage jobs

8 Academic studies have shown that if workers are risk-averse, then various forms of unemployment insurance not only improves risk sharing but also increases output by encouraging risk averse workers to seek high-wage jobs with high unemployment risk. See Daron Acemoglu and Robert Shimer, “Efficient Unemployment Insurance,” Journal of Political Economy, 107 (5), 1999, pp. 893-928. See also Daron Acemoglu and Robert Shimer, “Productivity Gains From Unemployment Insurance,” European Economic Review, 44 (7), 2000 pp. 1195-1224.
rather than continue searching for higher wage jobs, and would thereby result in fewer high-wage jobs in the overall economy.9

On the one hand, it is certainly true that workers would have an incentive to take a job more quickly because remaining unemployed would now be more costly. This could lead them to take lower paying jobs than they might otherwise take. On the other hand, however, a high-wage job would now be more valuable and less risky. This might actually create an incentive to search longer when unemployed.10 We believe that the magnitude of these implications of wage-loss insurance are likely to be small, and are unlikely to offset the benefits of such insurance.11

Our Proposal for a New Wage-Loss Insurance Program

Proposals for wage-loss insurance have been floated for quite some time in the ongoing U.S. policy discussions.12 Some limited financing for trying this on an experimental basis was included in the Omnibus Trade Act of 1988. But it took until the 2002 Trade Adjustment Assistance (TAA) program was enacted before a meaningful wage-loss insurance program was adopted—here, as an alternative to Trade Adjustment Assistance for workers over the age of fifty.13

A number of scholars have recently laid out several alternative templates for a broader wage-loss insurance program that would be a more-general benefit for

9 In addition there is a concern, which does not seem consistent with the concern listed above, that with wage-loss insurance the unemployed would somehow end up taking “good jobs” away from non-eligible workers.
10 Indeed, the day the program is passed all workers with high wages will find these more valuable because they will actually have higher expected lifetime earnings, since they would earn more in the event of displacement than before. In addition, it could encourage workers who have bargaining power to push for higher wages since job loss would be less risky. Moreover, it is hard to see why one would be against wage-loss insurance on the one hand, and in favor of the earned income tax credit, which also supplements wages and which is likely to have similar effects within certain ranges.
11 The best empirical evidence we know of comes from a Canadian experiment in which certain workers were granted wage-loss insurance at a 75% replacement rate. Only 4.4% of covered workers took jobs faster than they otherwise would have without this insurance (i.e., relative to workers who were not given this insurance). And there was no statistically significant difference in the re-employment earnings of covered versus uncovered workers. See Harold Bloom, et al, Testing a Re-employment Incentive for Displaced Workers: The Earnings Supplement Project, Social Research and Demonstration Corporation, Canada.
13 Alternative Trade Adjustment Assistance compensates manufacturing workers aged 50 and older who are deemed to have lost jobs to imports. If these workers take a new job paying less than their previous position, then they receive half the difference in wages, up to a level of $5,000 annually, for two years (provided that they found that new job within 26 weeks. In fiscal 2006, under this program $16.7 million in benefits were paid to 6,300 workers—far below the $50 million for the program estimated in 2002 by the Congressional Budget Office.
dislocated workers regardless of whether their displacement was attributable to trade. To be sure, different levels of generosity imply different total fiscal costs to any such program—and there is ample evidence that a program which fully compensated workers for their lifetime losses from dislocation would have to be far more prolonged and generous than the relatively limited ones that have been proposed. But a more limited program could nonetheless move in the right direction.

The Worker Empowerment Act of 2007, introduced by Sen. Charles Schumer (D-NY) and Rep. Jim McDermott (D-WA), has proposed one such comprehensive wage insurance program. This particular program would replace 50% of workers’ lost wages for up to two years, for up to $10,000 per year, provided that the workers meet certain requirements such as holding the previous job for at least two years. If limited to workers above age 50, this program is estimated to cost around $4 billion annually.

We propose the immediate adoption of a similar new wage-loss insurance program that broadly follows the guidelines proposed in the Worker Empowerment Act of 2007 but with eligibility for all workers aged 45 and older. With implementation costs and possibly higher payout rates, we forecast an annual cost of $7 billion.


15 In 2006 workers between 45 and 50 years old represented 28 percent of the workforce older than 45.
Section 2: Health Insurance Benefit for Workers in Transition

The current UI system presents a major risk to workers with employer-provided health insurance: the risk of paying more for, or of losing altogether, this health insurance while unemployed. We propose eliminating this risk by having the federal government provide credits for continuing employer-provided health insurance for unemployed workers currently covered by COBRA. The net annual cost of this new health insurance benefit would be about $10 billion.

Current Structure and Limitations of COBRA

Approximately two-thirds of Americans receive health insurance from their employer. But what happens to this health insurance when workers become unemployed? A generation ago, the U.S. Congress, as part of the Consolidated Omnibus Budget Reconciliation Act of 1986 (“COBRA”), enacted a number of provisions aimed at easing labor-market transitions. Most importantly, COBRA requires that employers continue to offer group health care coverage to certain former employees, retirees, and their dependents for a period of 18 months after they have left their jobs. COBRA can, therefore, help bridge from one job to another.

That said, COBRA faces several limitations in terms of how much it addresses workers’ fears about health care while unemployed. The first, of course, is the fact that it depends on the employee already having been part of an employer-provided group health plan. COBRA does nothing for employees transitioning from a job that lacked an employer-provided health care plan in the first place.16 Another limitation is that COBRA not only requires workers to pay, but also makes it likely they will pay more in after-tax dollars than they would have had their wages been reduced to cover health care while they were working. Although less expensive than individual health coverage, COBRA coverage almost

16 One obvious answer to the challenges faced by the insured and uninsured is to encourage broader reform of the U.S. healthcare system to better contain costs. Short of more fundamental health care reform, however, there are still things Congress could do in the short run to ensure that COBRA better served the needs of workers in transition.
invariably costs more for those involved (or forces them to accept less coverage than previously). This is because COBRA participants generally pay all premiums themselves, whereas their employers had paid for at least part of the premium while they were active employees.

Under current law, the tax code allows an employer to deduct the cost of providing health care to active employees. The coverage is not treated as additional income to the employee. Once an employee leaves his or her job, however, the tax consequences change significantly. The employee now bears the full cost of paying premiums for coverage—but these premiums are not deductible from his or her income unless these health care expenses exceed a statutorily prescribed threshold (calculated as a percentage of income) under rules governing deductions for itemized tax returns.

Our Proposal for a New Health Insurance Benefit for Unemployed Workers

This gap in health insurance is a major source of anxiety for job losers. We propose reducing it by having the UI system pay for any COBRA health insurance payments incurred while receiving UI income benefits. The resulting higher cost to the overall UI system would, we believe, be justified by the benefit of broader health insurance coverage and reduced worker risk.

Administering this program would be very simple. Employers would maintain health insurance for unemployed workers for as long as they collect unemployment insurance (unless they opt out). Employers would receive a credit for these health care expenses that could then be used to offset their state UI contributions.

What would this new UI benefit cost? Health insurance payments by employers are today equal to about 10% of the employer wage costs.\(^ {17} \) Since UI historically replaces 36% of all wages (see note 9), this suggests that employer-provided health insurance could be provided to unemployed workers for an additional 10/36 — i.e., an additional 27.8% — cost to UI. Total fiscal 2009 U.S. UI contributions were projected to be $36.1 billion, so this implies a total additional expense of $10.3 billion dollars: $77 per worker, per year ($1.50 per worker, per week) given the payroll-employment base of over 134 million workers.

This cost estimate is likely an upper bound because many unemployed workers continue receiving health benefits through the insurance of other family members. To provide an incentive to continue with such family insurance, we would propose that unemployed workers who can demonstrate access to such continued health insurance coverage would be eligible for slightly more generous UI-income supports (e.g., perhaps a 10% bonus).

To be sure, this health insurance plan has limitations. Eligibility would extend solely to those COBRA-eligible employees already participating in an employer-provided group health plan. As such, it does not help employees transitioning from a job that lacked an employer-provided health care plan in the first place. (It is worth underscoring here that one of the subsidiary benefits of broad reforms of the U.S. health care system would be lowering the cost to workers of job changes.) Nonetheless, our program would still help most workers by reducing one of the major anxieties caused by job loss.
Section 3:
Greater Access to Savings for Workers in Transition

Workers who undertake a career change or have one forced upon them may well need help beyond what the basic unemployment insurance program can reasonably provide. We would hope to encourage workers to save for such eventualities by allowing them to tap existing tax-advantaged savings vehicles when needed as part of their transition.

We would, as a consequence, propose providing new relief from penalties for withdrawals from common tax-preferred savings accounts to allow workers to tap their own savings to assist in their transition. This and other new tax-related preferences—described in the next section—should stimulate greater uptake by unemployed workers of job search, retraining, and relocation opportunities.

Private markets do not always provide for the financial needs of unemployed workers, many of whom are liquidity constrained. Workers might experience unemployment before they have accumulated sufficient savings. Precisely when they most need loans, their unemployed status makes it unlikely they will be able to get them. This cannot only hinder their ability to smooth consumption, but it also makes it difficult to meet the additional expenses associated with a job search, training to acquire new skills, and relocation often required to find new employment. 18

This all suggests a role for government assistance with programs broadly aimed at the twin goals of alleviating liquidity constraints and supporting the expenses related to job search, training, and relocation. Tax-preferred savings accounts are a central mechanism by which the government rewards thrift. Workers can contribute pre-tax dollars to IRA and 401(k) plans and post-tax dollars to Roth IRAs.

In normal circumstances, access to the proceeds in such an account without penalty is possible only when the account has been open at least five years and

18 A common conclusion of academic research is as follows: “Our results highlight two distinct roles for policy toward the unemployed: ensuring workers have sufficient liquidity to smooth their consumption, and providing unemployment subsidies that serve as insurance against the uncertain duration of unemployment spells.” Robert Shimer and Ivan Werning, 2005, “Liquidity and Insurance for the Unemployed,” National Bureau of Economic Research, Working Paper #11689.
when the individual funding it is 59½ or older. Penalties are waived, however, if withdrawn funds are used for certain broad purposes: for education costs; for first-time home purchase expenses; for death or disability payments; and for certain medical expenses, including certain health insurance costs for some unemployed individuals.

The logic behind such waivers is widely thought to be granting individuals and families access to savings when facing important spending obligations for family investment (education, homes) or for security (death, disability, and medical expenses). We think that this logic for tax-protecting certain savings withdrawals should be extended to the need for worker security during unemployment spells.

Specifically, we propose that an unemployed worker with 401(k), IRA, or Roth IRA accounts be granted penalty waivers to finance withdrawals used for several unemployment-related activities: income support equal to the lower of UI compensation or half his/her previous wage; a broadly defined set of education and retraining expenses s/he might choose to pursue; and relocation expenses to reach a new job. (While there is already an exception for higher education expenses we would make sure this is also available for occupational training, job placement and counseling, and moving expenses.) We note that beyond the direct benefit workers would realize from this proposal, there would be an indirect benefit of additional encouragement to individuals and their employers to establish and fund these tax-advantaged accounts.

All these withdrawals would be taxable unless they had been made on a post-tax basis, as in the case of Roth IRAs. However, we would also provide relief from taxes on spending to maintain health insurance. This would allow employees to preserve the tax-deductibility of their own health care contributions.

We forecast an annual cost of $2-3 billion for these new tax preferences for worker education, training, and relocation. This would be financed by the expanded UI revenue proposed in Section 4.
Section 4: Life-Long Learning

Encouraging Retraining, Skills Acquisition, and Life-Long Learning

We recommend that the current training afforded by TAA and WIA be consolidated into a series of programs that offer training assistance regardless of the current employment status of the recipient. These programs should be crafted in recognition of the fact that advancement in the current and future U.S. job market will require both post-secondary education and on-the-job experience.

Expanding Eligibility for Existing Training and Retraining Programs

Perhaps most importantly, we would eliminate TAA’s current requirement that a worker be required to show some nexus to trade or a shift of production overseas as the basis for providing assistance. Instead, we would make a training stipend available to every UI-eligible worker.

The reality most workers face today is a constant and accelerating pace of economic change that emanates from several sources, principally technology. Rather than facing a one-time adjustment to new levels of competition flowing from a trade agreement or a production shift, workers now face continual adjustment as new technologies and competitors, both domestic and foreign, make existing capital equipment and skills obsolete.

The aim here should be to rely to the maximum extent on the excellent infrastructure programs already offered by community colleges and technical schools across the country. We also recommend, however, that any reform

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19 Like UI, TAA suffers from age. Created in the early 1960s when Congress granted negotiating authority for what would become the Kennedy Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade, TAA was designed to assist workers who were put out of work as their industry faced new levels of competition following the removal of specific trade barriers. See discussion in Rosen (2006), from note 7. In 1993, Congress expanded the basic TAA program to take into account shifts in production from the United States to Mexico following the implementation of the North American Free Trade Agreement (NAFTA). Section 250(a), Subchapter D, Chapter 2, Title II, of the Trade Act of 1974, as amended, 19 U.S.C. 2273. Under the newly created NAFTA Transitional Adjustment Assistance program, eligibility no longer required a showing that an employee had been laid off due to increased levels of import competition of a “like product.” Id. Rather, the employer needed solely to show that there had been a shift in production from the employer’s U.S. plant(s) to facilities the employer owned in Mexico or Canada. Id.
proposal reflect the growing importance of the private education and training industry, which has developed to meet the needs of employers in many different industries and which can both expand offerings and reduce costs.\textsuperscript{20} This will practically mean that such private-sector programs would be eligible for federal training programs on par with traditional educational institutions. This approach would also encourage more public-private partnerships of the type that have proven successful in the past.

Ultimately, we should, as a society, encourage every worker to prepare for the future and facilitate their ability to do so.

Making training opportunities more broadly available to all workers in transition is not cost-free. While not all unemployed workers will apply for such training, making it more broadly available will still require a significant investment. Measuring just how much of an investment that would take is difficult because there is no common standard for the amount of (re)training expenses to cover. Nevertheless, we highly recommend expanding the current combined total of about $3 billion available under WIA and TAA training programs to encourage all workers to acquire new skills—regardless of the reason for dislocation.

\textbf{Expanding Workers’ Incentives to Invest in Themselves}

Ultimately, we should, as a society, encourage every worker to prepare for the future and facilitate their ability to do so. We think that two additional tax preferences can stimulate greater investment by both employed and unemployed workers in acquiring the skills to allow them to adjust with the economy.

The first step we would recommend is ending the absurdity of allowing the deductibility of training expense against income taxes only when those expenses are related to a worker’s current job. This is, in effect, a non-adjustment policy – one that provides an incentive to stay put, rather than build skills that would allow a worker to adjust with his or her employer and with the economy as a whole.

We would, as a consequence, recommend expanding the definition of training that qualifies for a deduction from current income taxes. All such expenses should be deductible, whether related to a current job or some prospective future job.

\textsuperscript{20} One of the developments largely unaddressed by the economic literature is the growth of a burgeoning private-education and training industry that serves the global talent demands of private companies. Estimates of the size of the education and training industry range from $58 billion and up. The dollars involved in this sector, which account for only a share of the total investment made by private industry in education and training, dwarfs the funds available under public programs.
Expanding Incentives for Firms to Invest in Their Workers

The second incentive we recommend would encourage firms to create innovative approaches in providing for employee training. Indeed, the tax treatment of training and education expenses should be modified to encourage the sorts of innovations already under way.

The recent experience of IBM is instructive here. In response to the global competition for talent, last year IBM introduced a new program for its employees, “Matching Accounts for Learning.” Designed to assist IBM employees in preparing for their own future, even in areas beyond IBM’s immediate business needs, in this program IBM will match 50% of contributions by employees with at least five years of service, up to $1,000 per year. Funds will be placed in an interest-bearing account and will be fully portable, even if the employee leaves IBM. This program comes in addition to the $600 million IBM already spends annually on learning programs that help IBM employees develop current skills.

Under current law, both the matching grant by IBM and the interest earned on the total amount saved will be taxed as current income to the employee in the year received. For its part, IBM receives no tax benefit in the form of a deduction—despite the fact that the payment is made as a part of a program designed to attract and retain highly motivated employees and helps fund education and training that will benefit IBM if the employee stays with the company.

We recommend two changes to current law that would result in tax treatment of this IBM-type account—we recommend calling them Worker Adjustment Accounts—paralleling that afforded to 401(k) plans. The first would allow the employee to exclude from current income both the funds he or she set aside and those provided by the employer. The second would amend the tax code to allow the employer to deduct these payments from current income as an ordinary and necessary business expense. In the event of withdrawals, the tax treatment would be similar to 401(k) and IRA accounts.

We forecast an annual cost of $2-3 billion for these new supports for worker retraining and learning. This would be financed by the higher level of UI revenue proposed in Section 5.
**Section 5: Funding The Adjustment Assistance Program**

**Reforming and Expanding UI Taxes**

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We propose two immediate major changes in funding for our Adjustment Assistance Program (AAP): (a) at the state level, replace the current system with a flat 1.2% tax on all earnings; and (b) at the federal level, change the Federal Unemployment Tax (FUTA) contribution to a flat rate of 0.12% on all earnings. These two changes would both make UI more progressive and would raise sufficient new funds—about $22 billion more per year—for our four new supports for unemployed workers: health care coverage; expanded access to tax-preferred savings accounts; new training access and adjustment accounts; and a wage-loss program once re-employed.

**Current Structure of Unemployment Insurance:**

**Funding and Uptake**

Unemployment Insurance (UI) is operated in a joint program between the state and federal governments. The federal government levies a Federal Unemployment Tax on employers to cover the costs of administering unemployment insurance and job service programs in all states. FUTA also provides funds (a) if state programs need to borrow to pay benefits and (b) by providing financing for extended benefits if states exceed unemployment thresholds. In addition, on an ad hoc basis, federal funds are provided if recessions become protracted.

States have programs that vary in duration and generosity but they follow a similar approach in conformity with federal requirements. The typical program provides to qualified workers up to 26 weeks of replacing some share—typically around 50%—of previous wages, capped at some ceiling. For fiscal 2009, expected average weekly benefits nationwide are $297, compared with average weekly earnings for non-supervisory workers in May 2008 of $604.58.

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21 There is also an extended-benefits program, funded half by the federal government and half by state governments. This permanent program provides an additional 13 or 20 weeks of benefits to jobless workers in states where the unemployment situation has worsened dramatically, regardless of whether the national economy is in recession. But few states have qualified for this program.

22 In response to recessions, the federal government has often provided funding for additional weeks of benefits in all states. The Temporary Emergency Unemployment Compensation (TEUC), enacted in March 2002, provides 13 extra weeks to all workers and 26 extra weeks in very high unemployment states.

23 In 2006, the average national UI benefit was 46.7% of the average weekly wage. (Source: [http://www.doleta.gov/unemploy/chartbook/chartrpt.cfm](http://www.doleta.gov/unemploy/chartbook/chartrpt.cfm))
State and federal programs are financed through employer contributions. Employers are assessed by states at a fixed rate up to a ceiling. Reflecting federal requirements, there is “experience rating” in which different firms are assessed different rates based on their differences in past UI uptake. In 2007, the average state contribution rate was 2.56% on a capped base of $13,800, which amounted to an effective rate of 0.73% of all earnings and an average state-level UI contribution of $290 per worker. The Federal component, FUTA, is assessed at a rate of 0.8 percent up to a ceiling of $7,000.24

Most workers earn more than this, so that most individuals contribute a flat annual amount of $56 for the federal component of UI. Fiscal 2009 FUTA revenue is projected to total $6.3 billion, and all fiscal 2009 UI revenue (and spending) is projected to total $36.1 billion.25

Workers become eligible to receive UI only if they have held their jobs for some time and if they are terminated for reasons beyond their control. They are typically eligible for replacement of around fifty percent of their wage earnings up to a certain ceiling for as long as they remain unemployed, up to 26 weeks.

**Our Twin Proposals for a More Progressive and Expanded UI Funding Structure**

The current UI program has been criticized on several grounds. First, coverage is often deemed too narrow because several classes of workers (e.g., part-time workers) are not eligible.26 Second, there are concerns about adverse incentives UI might create: that workers might delay their return to work, and that firms might fire workers more readily.

We think that the current UI program achieves reasonably well its goal of supporting income through unemployment spells. Because the replacement rate is partial rather than complete, most UI beneficiaries still have a considerable incentive to find new employment.27 Indeed most find work well before exhausting their full potential

“ONLY 18.3% of those unemployed had been out of work for 27 weeks or more.”

24 Details of current FUTA funding can be found here: (Source: http://workforcesecurity.doleta.gov/unemploy/uitaxtopic.asp)
25 State UI regular benefit outlays are estimated at $33.6 billion in the fiscal 2008 budget and $36.1 billion in 2009.
26 In the words of noted UI scholar Howard Rosen, “The current UI system does not assist workers who seek part-time employment, workers who voluntarily leave one job in order to take another, or workers who experience long-term unemployment. New entrants and re-entrants into the labor market are not currently eligible for UI.” (Source--http://www.iie.com/publications/papers/paper.cfm?ResearchID=727)
27 Howard Rosen reports that the U.S. replacement rate averaged 36% between 1975 and 2004.
of 26 weeks of benefits. In May 2008 the mean duration of unemployment spells was 16.6 weeks, the median duration was 8.3 weeks, and only 18.3% of those unemployed had been out of work for 27 weeks or more.

That said, one major concern about our current UI system is its regressive funding mechanisms. It is particularly regressive because the wage ceiling for payments is much higher than for contributions: this feature redistributes income from lower-wage to higher-wage workers. Consider two workers, with respective annual earnings of $14,000 (the ceiling for payments) and $50,000. Under current UI funding rules, both would make identical payments into the UI system. But if both became unemployed and received 26 weeks of UI at a 50% replacement rate, then their respective UI benefits would total $7,000 and $25,000.

To remedy this regressivity of the current UI system and raise the funds for our proposals we recommend a flat rate of 1.32% be assessed on all wages. This would entail two funding changes: one at the state level and one at the federal level.28

- State-level contributions should be set at 1.2%. A flat rate of 0.73% would raise the same total revenue as the current state system. To pay for the new benefits we propose, however, we would need to raise additional revenues.

- FUTA should be restructured to be a 0.12% tax on an uncapped base of all payroll earnings rather than the current 0.8% on the first $7,000. In fiscal 2009 FUTA revenue is projected to total $6.3 billion. Removing the FUTA ceiling and keeping the same total revenue would require a rate of about 0.12%. This would represent a tax cut on FUTA contributions for all workers who today earn up to $47,000.

All told, although this approach would raise more money compared to the current system, it would reduce employment taxes on all workers earning less than $30,000 annually.

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28 Total wages in the 12 months ending in the first quarter of 2008 were $4.776 trillion. (Source: Page 9 of http://workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum08/DataSum_2008_1.pdf) This amount of total wages is used in our calculations below.
Conclusion: The Way Forward

The policies we have proposed would, if enacted together, greatly expand labor-market supports for American workers. The total annual cost of these new programs we advocate would be about $22 billion: $10 billion for the health insurance program; $5 billion for the tax-related supports for education, training, and relocation; and $7 billion for the wage-loss insurance. This $22 billion per year would come from our reform and expansion of the UI tax base.

The cost of these new labor-market supports must be seen in the context of the current protectionist drift in U.S. policy away from trade and investment liberalization. Global engagement has generated, and has the potential to continue generating, very large gains for the United States—and for the rest of the world as well.

Living standards in the United States today are upwards of $1 trillion higher per year in total than they would have been absent decades of trade, investment, and immigration liberalization. Looking ahead, annual U.S. income could be upwards of $500 billion higher with a move to global free trade and open investment policies. We hope that our policy proposals help achieve this sort of expansion—and thereby ongoing gains from global engagement.

“Looking ahead, annual U.S. income could be upwards of $500 billion higher with a move to global free trade...”
Background: Succeeding in the Global Economy

In June of 2007, the Financial Services Forum released a study that continues to shape the discussion in Washington regarding U.S. trade policy and our nation’s response to the opportunities and challenges of globalization. The report, Succeeding in the Global Economy: A Policy Agenda for the American Worker, illustrates in clear and compelling terms the tremendous economic gains that free trade and globalization have generated for the United States and the world.

Importantly, the report also acknowledges that trade and globalization can also entail real and painful localized losses, and offers a new agenda of innovative policy ideas to help American firms, workers, and communities disaffected by evolving job patterns to adjust, re-engage, and benefit from the 21st century global economy. That report is available at www.financialservicesforum.org.

This white paper is a follow-up to our June 2007 report and expands on ideas that received a great deal of attention from policymakers and the media.

In the months ahead, the Forum will release a second white paper expanding on another proposal from the June 2007 study. This research document will detail an insurance mechanism to help communities deal with dislocations and challenges related to the our 21st century global economy.
Grant D. Aldonas

Grant D. Aldonas is the founder and principal managing director of Split Rock International, Inc., a global consulting and investment advisory firm based in Washington, D.C. Split Rock advises companies, investors, non-governmental organizations and international financial institutions on their global strategy, as well as incubating businesses that serve the bottom of the economic pyramid in the developing world.

Grant teaches courses in the resolution of international trade disputes and trade law and development as an Adjunct Professor in the Institute for International Economic Law at Georgetown University Law Center. Grant serves on the Institute’s Board of Advisers and Co-Chairs its flagship program, the WTO Academy.

Grant serves as Senior Adviser to the Center for Strategic and International Studies, where his research and writing focuses on globalization, innovation, international trade and development. He is currently at work on two books, one on trade and development; the other on economic policy in a global age.

Before founding Split Rock, Grant was a partner with Akin Gump Strauss Hauer & Feld, where his practice focused on international trade, investment, corporate governance, and corporate social responsibility. While at Akin Gump, Grant served as chair of the U.S. arm of Transparency International, the leading non-governmental organization fighting corruption globally.

From 2001 to 2005, Grant served in the Bush Administration as the Commerce Department’s Under Secretary for International Trade, where he was one of the President’s principal advisers on international economic policy.

Grant served concurrently as a member of the board of the Overseas Private Investment Corporation, which is the leading U.S agency financing investments in the developing world. He also served as Executive Director of the President’s Export Council and the Trade Promotion Coordinating Committee.

Prior to his service in the Administration, Grant was the Chief International Trade Counsel to the Senate Finance Committee. During his tenure, the Congress passed a number of significant trade measures, including the landmark Trade and Development Act of 2000.

Before joining the Finance Committee staff, Grant was a partner with the Washington, D.C., law firm of Miller & Chevalier. During his tenure with the firm, Grant also served as counsel to the Bipartisan Commission on Entitlement and Tax Reform and as an adviser to the Commission on U.S.-Pacific Trade and Investment.

Grant began his career as a Foreign Service officer before joining the Office of the U.S. Trade Representative, where he was responsible for trade and investment relations with Latin America and the Caribbean. Grant received his B.A. in international relations in 1975, with a concentration in economic development, and his J.D. in 1979 from the University of Minnesota.
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Dr. Lawrence served as a Member of President Clinton’s Council of Economic Advisers from March 1999 to January 2001. Dr. Lawrence has held the New Century Chair as a non-resident senior fellow at the Brookings Institution, and founded and edited the Brookings Trade Forum.

Dr. Lawrence has been a senior fellow in the Economic Studies Program at the Brookings Institution (1983-91), a Research Associate at Brookings (1976-82), an instructor at Yale University (1975), and a professorial lecturer at the Johns Hopkins School of Advanced International Studies (1978-81). He has served as a consultant to the Federal Reserve Bank of New York, the World Bank, the OECD, and UNCTAD. He was also a member of the Presidential Commission on United States Pacific Trade and Investment Policy, and has served as a member of the advisory committees of the Institute for International Economics, the Panel on Foreign Trade Statistics of the National Academy of Sciences, the Committee for Economic Development, the Overseas Development Council, and the Panel of Economic Advisors of the Congressional Budget Office.


Dr. Lawrence was born in Johannesburg, South Africa. He immigrated to the United States in 1971, and studied in the U.S. at Yale University where he received his Ph.D. in Economics in 1978.
Matthew J. Slaughter

Matthew J. Slaughter is Associate Dean of the MBA Program and Professor of International Economics at the Tuck School of Business at Dartmouth. He is also currently a Research Associate at the National Bureau of Economic Research; a Senior Fellow at the Council on Foreign Relations; an academic advisor to the McKinsey Global Institute and the Private Equity Council; and a member of the academic advisory board of the International Tax Policy Forum.

From 2005 to 2007, Slaughter served as a Member on the Council of Economic Advisers in the Executive Office of the President. In this Senate-confirmed position he held the international portfolio, advising the President, the Cabinet, and many others on issues including international trade and investment, currency and energy markets, and the competitiveness of the U.S. economy. In recent years he has also been affiliated with the Federal Reserve Board, the International Monetary Fund, the World Bank, the National Academy of Sciences, the Institute for International Economics, and the Department of Labor.

Slaughter’s area of expertise is the economics and politics of globalization. Much of his recent work has focused on the global operations of multinational firms, in particular how knowledge is created and shared within these firms and how their activities are structured cross borders. He has also researched the labor-market impacts of international trade, investment, and immigration, and has studied the political-economy questions of individual attitudes about and government policies towards globalization. This work has been supported by several grants from organizations including the National Science Foundation and the Russell Sage Foundation.

Slaughter has published dozens of articles as book chapters and in peer-reviewed academic journals. He also co-authored the book Globalization and the Perceptions of American Workers, and he currently serves in various editorial positions for several academic journals.

In addition to numerous presentations at academic conferences and seminars, Slaughter has testified before both chambers of the U.S. Congress. He frequently contributes op-eds to the Wall Street Journal, and his work and ideas have been widely featured in business media such as Business Week, The Economist, Financial Times, New York Times, Newsweek, Time, Wall Street Journal, and Washington Post. He has been interviewed on many TV and radio programs such as CNN’s Lou Dobbs Tonight and NPR’s Morning Edition. In recent years he has also served as a consultant both to individual multinational firms and also to industry organizations that support dialogue on issues of international trade, investment, and taxation. And at Tuck he co-directs the flagship executive-education program Global Leadership 2020.

Slaughter joined the Tuck faculty in 2002. Prior to coming to Tuck, since 1994 he had been an Assistant and Associate Professor of Economics at Dartmouth, where in 2001 he received the school-wide John M. Manley Huntington Teaching Award. Slaughter received his bachelor’s degree summa cum laude and Phi Beta Kappa from the University of Notre Dame in 1990, and his doctorate from the Massachusetts Institute of Technology in 1994.
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