Testimony Before the House Ways and Means Subcommittee on Human Resources
Hearing on Unemployment Benefits and “Returns to Work”

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Thank you for giving me the opportunity to submit testimony on the Unemployment Compensation (UC) system and the effect of UC benefits on the reemployment of recipients.

The UC system is designed to alleviate the hardship caused by involuntary unemployment. But by paying benefits to recipients during their unemployment spells, the system also creates a reemployment disincentive for at least some recipients. Policy makers therefore must set a benefit amount that balances two conflicting goals: (1) providing adequate benefits to meet the needs of the unemployed, and (2) minimizing the reemployment disincentive. To achieve this balance, the “rule-of-thumb” that has guided UC policy since the inception of the system is that weekly UC benefits should replace roughly 50 percent of workers’ weekly wages (O’Leary and Rubin 1997).

I will base my remarks on three conclusions related to the reemployment disincentives of the UC system:

• Expanding the generosity of UC lengthens unemployment spells.
• States UC policies can shorten UC spells.
• Reemployment bonuses can generate modest reductions in UC spells but are generally not cost-effective.

Expanding the Generosity of UC Lengthens Unemployment Spells

The UC system creates a disincentive to reemployment because it lowers the cost of unemployment. Unemployed workers who have access to UC will tend to reduce the intensity of their job search or to be more selective in accepting a job offer than they would be in the absence of UC. Both of these tendencies generate longer unemployment spells. Increasing the generosity of the system, either through increased benefit amounts or additional weeks, adds to this effect.

Effect of the weekly benefit amount. Studies consistently show that higher weekly UC benefits lead to a modest increase in the length of unemployment. Most studies have focused on the effect of changes in the wage replacement rate—the ratio of the weekly benefit amount to the pre-UC weekly wage—which, as I have pointed out, is intended to average about 50 percent in the current system. Studies conducted since the early 1980s suggest that an increase in the
replacement rate of 10 percentage points lengthens average unemployment spells by between 0.5 and 1.5 weeks (Moffitt and Nicholson 1982; Moffitt 1985a; Solon 1985; and Meyer 1990). Hence, if weekly benefits are increased because of concerns about adequacy, the result will be somewhat longer unemployment spells.

Effect of the maximum duration of benefits. Increases in the maximum duration of benefits also lengthen average unemployment spells. Studies since the early 1980s suggest that a one-week increase in maximum duration of benefits extends average unemployment spells by between 0.1 and 0.5 weeks (Moffitt and Nicholson 1982; Moffitt 1985a and 1985b; Solon 1985; Katz and Meyer 1990; Corson et al. 1999; and Jurajda and Tannery 2003). This range of estimates is fairly wide, implying, for example, that an extension of maximum benefit duration from 26 weeks to 36 weeks could lengthen average unemployment spells by as little as 1 week or by as much as 5 weeks.

State UC Policies Can Shorten UC Spells

Work-search requirements. To counter the disincentive effects of UC, states can use work-search requirements to promote more rapid reemployment. In most states, recipients must provide the UC agency with a list of a minimum number of potential employers contacted for each week during which benefits are claimed. However, UC agencies usually do not aggressively validate the information that UC recipients provide, which leads one to question the effectiveness of the work-search requirements in offsetting the reemployment disincentive of UC. Regardless, evidence suggests that the work-search requirements have a substantial impact. A Washington State UC experiment conducted during the 1990s showed that, relative to a system with no required employer contacts, standard work-search requirements in that state reduced average UC benefit spells by more than 3 weeks per recipient (Johnson and Klepinger 1994). Evidence from another experiment conducted in Maryland during the 1990s demonstrated that additional strengthening of the standard work-search requirements, either through increases in the number of required contacts or through verification of the contacts, further reduced benefit receipt (Klepinger et al. 1998).

Targeted job-search assistance. The state Worker Profiling and Reemployment Services (WPRS) programs that were established a decade ago can also offset the reemployment disincentive effects of UC. These programs require UC recipients identified as most likely to exhaust their benefits to participate in mandatory job-search assistance services. A recent evaluation of WPRS programs in six states found that the programs generated reductions in UC receipt in five of the six states, with the reductions in a given state ranging from 0.2 weeks per recipient to nearly 1 week per recipient (Dickinson et al. 1999). Reductions were largest in states that had extensive service requirements, and that strictly enforced those requirements.

Reemployment Bonuses Can Generate Modest Reductions in UC Spells but Are Generally Not Cost-Effective

Evidence from the bonus experiments. A series of experiments were conducted during the late 1980s to test the potential effectiveness of reemployment bonuses in encouraging more rapid reemployment and reducing UC payments. The bonus offers tested ranged from about
$300 to $1,000 and were paid to recipients who found a new job within about 6 or 12 weeks of their initial UC claim, depending on the particular experiment.

The reemployment bonus offers reduced average UC receipt, with the estimated reductions ranging nearly as high as 1 week per recipient for the most generous offers. However, these reductions were not large enough to make the reemployment bonuses cost-effective from the standpoint of the UC system—the costs of administering and paying the bonuses exceeded the estimated savings in UC payments generated by the offers (Decker and O’Leary 1995). Furthermore, unemployed workers who previously had not applied for UC might be induced to do so if the reemployment bonus were made permanent. This effect, often referred to as an entry effect, would add to the net costs of offering a permanent reemployment bonus beyond what was measured in the bonus experiments.

Reemployment bonuses may be more cost-effective if they are targeted to certain UC recipients, as is done with WPRS services. O’Leary et al. (2003) have shown that targeting of reemployment bonus offers to UC recipients who are expected to exhaust their benefits can generate larger reductions in UC payments for a given bonus offer. This research also suggests that these reductions in UC payments may be large enough to pay for the costs of administering and paying the bonuses.

**Personal Reemployment Accounts.** Personal Reemployment Accounts, or PRAs, have been proposed as part of the President’s stimulus package to provide reemployment assistance to UC recipients who are most likely to exhaust their benefits. Recipients would use the PRAs, which could contain as much as $3,000 each, to pay for services and training to help them return to work sooner. The accounts would also include a reemployment bonus provision. PRA recipients who become reemployed within first 13 weeks of their first UC payment would be eligible for a reemployment bonus equal to the remaining balance in the PRA. If the PRA amount were set to the maximum value of $3,000, the maximum reemployment bonus amount would be considerably more generous than the bonus offers tested in the experiments.

Using the estimates from the bonus experiment, I predict that the reemployment bonus feature of a PRA set at $3,000 would generate a reduction in average UC spells among PRA recipients of more than 1.5 weeks. The predicted impacts under PRAs are larger than the estimated impacts in the bonus experiments because (1) the more generous PRA amount should speed reemployment and therefore reduce benefits received; and (2) the targeting of the PRA bonus focuses on individuals who expect to have long UC spells, so it should magnify the reduction in UC.

**Conclusion**

Although research has clearly demonstrated that the UC system introduces a reemployment disincentive, researchers disagree on the importance of this effect. The dispute arises partly because estimates of the effect of UC generosity on unemployment spells vary, and partly because different researchers describe similar estimates in different ways. Where one researcher characterizes an effect as “substantial,” another views it as “modest.” Regardless, reemployment disincentives are inevitable in UC insofar as it pays recipients for staying unemployed. The task
of policy makers, therefore, is to balance that disincentive against the need to provide adequate assistance to the unemployed.

References


