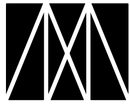

MERCATUS CENTER
George Mason University

POLICY BRIEF
SPECIAL EDITION

A Timely Redux for Personal Unemployment Insurance Savings Accounts

Veronique de Rugy

April 3, 2020

In response to the coronavirus pandemic, local and state governments ordered households to self-quarantine and nonessential businesses to shut down. The economy slowed to a crawl and people lost their jobs. Three million new jobless claims were filed in the last week of March, and that was just the beginning of the crisis.[1] Also at the month's end, Congress scrambled to pass the third phase of the stimulus package, the CARES Act, to keep the economy from falling into a Great Depression–style recession. A key component of the act is a boost for unemployment insurance benefits to private- and public-sector employees.

The unemployment insurance (UI) benefit expansion offers much-needed financial support for newly unemployed workers, but it can be improved by additional legislation. I propose *personal UI savings accounts* as a supplement to the stimulus package as well as a long-term solution to the challenge of designing incentives within UI programs. The recovery will depend, in no small measure, on people swiftly returning to work.

UNEMPLOYMENT INSURANCE AND THE CARES ACT ROUTE

Unemployment insurance is a joint federal and state program financed through payroll taxes. Each state operates its own program under federal guidelines. States set their own eligibility requirements, coverage limits, and financing methods. Each state follows a different formula. In general, however, most states provide unemployment benefits that replace about half of a worker's previous wages (all states disregard some earnings) for up to 26 weeks.[2]

This special edition policy brief is intended to promote effective ideas among key decision-makers in response to the COVID-19 pandemic. It has been internally reviewed but not peer reviewed.

For more information, contact the Mercatus media team at 703-993-9967 or media@mercatus.gmu.edu.

The views presented in this document do not represent official positions of the Mercatus Center or George Mason University.

The program in Virginia is illustrative. The state pays UI benefits equal to half of the worker's previous wages up to a maximum of $378 per week. The 50 percent replacement of previous wages holds for employees earning up to $39,312 annually and declines as salaries rise above that level. A result is that an unemployed worker who earned $100,000 annually receives a 19.6 percent replacement rate.

Meanwhile, in Washington State UI benefits are available for half of the individual's previous wages up to a maximum of $790 per week. The 50 percent replacement of previous wages holds for employees earning up to $82,160 annually. An unemployed worker who made $100,000 per year thus receives a 41 percent replacement rate.

During nationwide downturns, the federal government usually provides supplemental funding to increase the UI replacement rate or to lift the upper limit on benefits, or both. It can also increase the number of weeks the unemployed worker is eligible for UI. For instance, during the Great Recession, the federal government allowed UI recipients to receive up to 99 weeks of benefits. It also funded an across-the-board increase in benefits of $25 a week. Finally, it gave billions of dollars of "modernization" funding to the states in exchange for an expansion of state benefit structures—thereby creating future spending obligations for the states, since those billions of dollars won't cover the cost of the permanent expansion in benefits.[4]

THE CARES ACT TAKES A DIFFERENT ROUTE BY EXPANDING UI BENEFITS BY $260 BILLION

First, the act expands UI benefits for workers who were already eligible for UI benefits under state or federal regulation.[5] Because the states have in place different systems and different coverages, workers will receive from the federal government a $600 check weekly until July 2020, regardless of hours worked and in addition to their regular UI benefits under state law.[6] If individuals remain unemployed after their state employment benefits are exhausted—which is usually 26 weeks—the federal government will fund up to 13 additional weeks at a weekly rate of $600.[7]

The act will also provide funding to states that already have or will implement a short-time compensation program for employers that reduce their employees' hours instead of laying them off. Until December 31, 2020, the federal government will fund 100 percent of the employees' prorated unemployment-benefits costs for states that do have such a program and 50 percent for those states that choose to implement one.[8]

Second, the legislation creates a temporary federally funded Pandemic Unemployment Assistance to provide eligibility for those who would not otherwise qualify for state UI but who cannot work because of the ongoing pandemic.[9] This group includes self-employed workers, independent contractors, part-time employees, and those who quit their jobs for coronavirus-related issues (such

as workers who are sick or taking care of a dependent, if these workers do not otherwise have paid-leave benefits or telework).

Under the Pandemic Unemployment Assistance, these displaced workers do not have to look for other jobs. Benefits will cover 100 percent of these workers' weekly compensation while guaranteeing each of them a weekly check of at least $600 regardless of hours worked. These payments begin retroactively on January 27, 2020, and are scheduled to end on December 31, 2020, up to a maximum of 39 weeks.

The extended unemployment benefits are separate and independent from the means-tested $1,200 direct cash payments to individuals plus $500 per child.[10]

THE RISK OF CROWDING OUT MARKET INCENTIVES

The unintended consequences and moral hazard of UI during normal times and normal recessions are well known.[11] Put briefly, generous UI benefits create an incentive for workers to delay looking for jobs until the expiration of the benefit. In 2010, Harvard University economist Robert Barro estimated that the Great Recession expansions in UI benefits raised the US unemployment rate by about 2.7 percentage points.[12] Other economists found smaller increases, but still ones with a significant impact—and an impact especially upon male employment.[13]

In addition, economists Lawrence F. Katz and Bruce D. Meyer observe that workers receiving unemployment benefits were likely to postpone their job searches until their benefits expired.[14] This finding was confirmed by many other studies, including one by economist Alan Krueger, who wrote in 2008 that "job search increases sharply in the weeks prior to benefit exhaustion."[15]

Economists Julie Cullen and Jonathan Gruber find that families respond to unemployment benefits by reducing other income. Wives' earnings fall by between 36 and 73 cents for each dollar of UI benefits received by their husbands.[16] Finally, Eric Engen and Gruber find that expanded UI benefits reduce incentives to save.[17] This study finds that raising the replacement rate for UI (the percentage UI covers of a claimant's previous wages) by 10 percent lowers financial assets committed to cover regular income (savings people deploy when unemployed) by 1.4 to 5.6 percent.

In summary, this research suggests that a lot of people—not a majority, but a large portion nonetheless—postpone their search for a new job until the end of the unemployment benefits is in sight. The research also suggests something banal but often forgotten: the larger the relief from UI, the larger the chance that some people will fall under the illusion that finding a job is not an urgent matter.

Those lessons are just as clear and present as the necessity, for humane and economic reasons, for governments to support the unemployed under the current circumstances. The newly unemployed,

through no fault of their own, have lost their jobs and, worse, cannot go out in the streets in search of a new one. What gives? The CARES Act is fully justified in its expansion of unemployment benefits, but the means it uses are irreparably counterproductive, and the scale of the expansion compounds the problem. But there is a way forward. I recall an old policy proposal that should receive new attention—a proposal that by design encourages people to go back to work as quickly as they can, but also allows the compassionate relief brought to families by federal interventions like the CARES Act to continue when needed (e.g., during a recession).

PERSONAL UNEMPLOYMENT INSURANCE SAVINGS ACCOUNTS

Personal unemployment insurance savings accounts (PISAs) are designed to maintain a financial incentive to return to work as soon as possible. These accounts are individually owned by workers who, during spells of unemployment, can make orderly withdrawals to partially compensate for the loss to their income but can keep and build the balance during their regular times of employment. At the time of retirement, workers can use the balance in these accounts to bolster their retirement income or transfer to their heirs.

The incentive for workers to return to work is as strong as their desire to keep their own savings for retirement. It is thus a solution that solves the double bind of providing insurance and keeping strong incentives to return to work.

These PISA accounts would replace the current unemployment insurance program. They can be funded by employers as a mandatory contribution to the accounts of their employees. But plans should also allow employees to contribute voluntarily, in addition to their employers' contribution, thus giving them a chance to obtain better UI and stronger savings for retirement.

This form of UI is not a mere theoretical proposition. The experience of Chile is worth noting, but other countries such as Austria and Colombia have adopted similar plans. The empirical evaluation of the Chilean experience bodes well, as it seems that all workers were better off, or at least at par with the old program. First, the historically uninsured—the self-employed and those terminated with cause—started to enjoy this new protection. Second, salaried workers terminated without cause were allowed to make withdrawals that were comparable to older plan payments. The third group, those who never lost their jobs, could collect a payment from their accounts upon retirement.[18]

A PISA program for the United States must be carefully developed. The Chilean program is a good template, but the obvious differences between the two countries (e.g., the size of the economy and the complexity of the federal system) demand a complex set of innovations upon the Chilean model. It is nevertheless easy to envision that a PISA program in the United States could readily accommodate an expansion of benefits paid for by government during a recession. In fact, the CARES

Act expansion of unemployment insurance could be revised to start PISAs for American workers without changing the size of the support they receive, so as to include a powerful incentive for returning to work as soon as possible: they get to keep the balance in their savings account.

ABOUT THE AUTHOR

Veronique de Rugy is a senior research fellow at the Mercatus Center and a nationally syndicated columnist. Her primary research interests include the US economy, the federal budget, homeland security, taxation, tax competition, and financial privacy. She received her MA in economics from the Paris Dauphine University and her PhD in economics from the Pantheon-Sorbonne University.

NOTES

1. Department of Labor, "Unemployment Insurance Weekly Claims," news release, April 2, 2020, https://www.dol.gov/ui/data.pdf.
2. US Library of Congress, Congressional Research Service, *Unemployment Insurance: Programs and Benefits*, RL33362, October 18, 2019.
3. US Bureau of Labor Statistics, *Public Workforce Programs during the Great Recession*, July 2014, https://www.bls.gov/opub/mlr/2014/article/public-workforce-programs-during-the-great-recession.htm.
4. Chris Edwards and George Leff, "Failures of the Unemployment Insurance System," Downsizing the Federal Government (Cato Institute), June 1, 2011, https://www.downsizinggovernment.org/labor/failures-of-unemployment-insurance.
5. Committee for a Responsible Federal Budget, "What's in the $2 Trillion Coronavirus Relief Package?," March 25, 2020, http://www.crfb.org/blogs/whats-2-trillion-coronavirus-relief-package.
6. Coronavirus Aid, Relief, and Economic Security [CARES] Act § 2014, H.R. 748, 116th Cong., 2nd Sess. (2020).
7. CARES Act § 2107.
8. CARES Act §§ 2108, 2109.
9. CARES Act § 1202.
10. Individuals making less than $75,000 in 2018 will be eligible for the full payment of $1,200. Couples who filed jointly and made less than $150,000 will get $2,400. An individual who filed as head of household and earned $112,500 or less will get $1,200. In addition, each child in the household will receive $500. For individuals making more than $75,000, the payment will be reduced by $5 for every $100 of income that exceeds the limits. The payment decreases to zero for an individual making $99,000 or more or a couple making $198,000 or more.
11. Johannes F. Schmieder and Till von Wachter, "The Effects of Unemployment Insurance Benefits: New Evidence and Interpretation," *Annual Review of Economics* 8 (October 2016): 547–81.
12. Robert Barro, "The Folly of Subsidizing Unemployment," *Wall Street Journal*, August 30, 2010. See also Bruce D. Meyer and Wallace K. Mok, "Quasi-Experimental Evidence on the Effects of Unemployment Insurance from New York State" (NBER Working Paper No. 12865, National Bureau of Economic Research, Cambridge, MA, January 2007).
13. Shigeru Fujita, "Effects of Extended Unemployment Insurance Benefits: Evidence from the Monthly CPS" (working paper, Federal Reserve Bank of Philadelphia, 2011).

14. Lawrence F. Katz and Bruce D. Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics* 41, no. 1 (1990): 45–72.

15. Alan B. Krueger and Andreas Mueller, "Job Search and Unemployment Insurance: New Evidence from Time Use Data," *Journal of Public Economics* 94, no. 3-4 (2010): 298–307.

16. Julie B. Cullen and Jonathan Gruber, "Does Unemployment Insurance Crowd Out Spousal Labor Supply?," *Journal of Labor Economics* 18, no. 3 (2000): 546–72.

17. Eric Engen and Jonathan Gruber, "Unemployment Insurance and Precautionary Saving" (NBER Working Paper No. 5252, National Bureau of Economic Research, Cambridge, MA, September 1995).

18. Francesca Valentini, "Unemployment Insurance Savings Accounts: An Overview" (ETLA Discussion Papers No. 1136, Research Institute of the Finnish Economy [ETLA], Helsinki, 2008). See also Gonzalo Reyes Hartley, Jan C. van Ours, and Milan Vodopivec, "Incentive Effects of Unemployment Insurance Savings Accounts: Evidence from Chile," *Labour Economics* 18, no. 6 (December 2011): 798–809.