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Think like a Stakeholder, not like a Dependent

A New Take on Unemployment Insurance

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Paying people not to work will ease unemployment.

There is something wrong with this statement. Nevertheless, when it comes down to it this is exactly the rationale some have regarding the current state-sponsored unemployment insurance (UI) systems. They are programs that attempt to help people through difficult times after involuntary layoffs. The hope is to get people on their feet, by providing them an income as they look for a new and acceptable job. No argument there. However, study after study (even those conducted by economists in the Obama Administration) have shown that the current UI system actually prolongs unemployment, stalls economic growth, and discourages individual savings.

In an attempt to mitigate these problems, and preserve an unemployment insurance program, the Oregon-based Cascade Institute has proposed an interesting solution. It calls for a hybrid program consisting of tax-free Individual Asset Accounts (IAA) and a small federal common-pool fund. The idea is to make workers stakeholders in their own plans and use current tax dollars to increase private wealth.

Currently, the Social Security Act compels the states to operate Unemployment Insurance (UI) systems. The plans are predominantly run by the states and funded through payroll taxes paid by the employer based on their layoff history. Those who layoff more, pay a higher rate.

Overall, there are three problems in the current UI system worth noting.

First, studies show that unemployed workers who receive benefits take more than twice the time to find a job than those who are not eligible for benefits. Why? Alan Reynolds from the Cato Institute says it best: “When the government [in some cases] pays people 50 or 60 percent of their previous wage to stay home for a year or more, many of them do just that.” It’s the classic “when you subsidize something, you get more of it” routine. The promise of benefits discourages the unemployed from looking harder for new work. Reynolds cites a survey conducted by Bruce Meyers of the University of Chicago showing that the probability of a person leaving unemployment rises dramatically just prior to when benefits run out. For example, if benefits are extended to 79 weeks – as they were in the “stimulus” bill – there is a higher likelihood that many people will not accept work until the 76th or 78th week.

Second, the supposed economic benefits of unemployment insurance are balderdash. Spending money over a long period of time to sustain a person who is not working is not an investment in economic growth. As a matter of fact, research done by economist Sylvain Leduc shows that government spending produces a lower fiscal multiplier than do tax cuts. In other words, a dollar of added federal debt added as a result of increased spending added far less than a dollar to GDP.

Third, safety nets like UI discourage personal savings and responsibility. This occurs under the assumption the government will protect people in the event of job loss. Saving helps the economy by generating a greater supply of loanable funds, thus lowering interest rates and stimulating capital investments.

The Cascade Policy Institute has an interesting solution to the current problems of the UI system, which they hope to pilot in Oregon. Their plan calls for a hybrid system that features Individual Asset Accounts (IAA) and a small common-pool fund. Employers would still pay state payroll taxes but the funds would be put into the employee's IAA, while the federal payroll tax would fund the common fund. The tax rate for employers to fund the IAA's would be 1.6 percent of wages, while the federal common fund rate would remain at its current 0.8 percent of the first $7,000 of wages. This common fund would be used to subsidize qualified low balance accounts for a limited time.

The IAA would accumulate tax free for life and could be used at the discretion of each worker for unemployment insurance. At retirement, the accounts balance would be deposited into the worker's IRA, turned into an annuity, given as a lump sum transfer, or passed onto heirs.

This innovative plan would encourage individuals to think like stakeholders, since they are the ones who own the account. In the event of layoff, individuals could draw from their account. At the same time they would be more cost conscious and encouraged to step up their job search efforts. In addition, the savings being built up with the IAA's would have a positive effect on the economy by providing more capital for businesses to expand. And lastly, many who currently pay into the Oregon UI system but are not eligible for benefits (either because they have not worked the required minimum 500 hours or have not earned sufficient wages) would now be able to participate in the system.

At a time when the country faces high unemployment rates all options should be on the table for policymakers. Evidence shows that the current UI system actually prolongs unemployment and economic recovery. As such, reforms to this system should be front and center on the minds of those in state governments. IAA's are a good start.

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Even conservatives have argued for unemployment benefits (not that they are right or wrong)...the economic consequences are considered a mixed bag, and Alan Reynolds is not the sole voice on the issue. The CBO's calculations on the economic effects of unemployment benefits are likely more in line with a realistic forecast of the costs/benefits. If unemployment benefits boost GDP by a factor of >1 per dollar then they're worth it from an economic perspective. This may not be true of a welfare or substantive justice perspective. If it's

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