Lessons Learned from the Earnings Supplement Project

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Introduction

This presentation will focus on what was learned from a demonstration project that took place in Canada in the mid-1990s to test an innovative approach to help displaced workers reintegrate the labour market faster. The project was sponsored by HRSDC and was implemented and evaluated by the Social Research and Demonstration Corporation.

We first review the lessons learned from that important and unique social experiment and then comment on whether or not such an approach would be appropriate in today's context as a policy tool to address problems faced by displaced workers.

The ESP Program Model

The Earnings Supplement Project (ESP) was a test of whether a financial incentive can encourage unemployed people to return to work more quickly than they otherwise would. The primary goal was to shorten the often long and painful re-employment process experienced by displaced workers. In addition, it was hoped that, by encouraging re-employment, the incentive would reduce the cost of unemployment benefits.

ESP offered eligible EI recipients in selected CECs, a supplement to their earnings if they experienced a reduction in earnings when they left EI to go back to work. An earnings supplement operates on the supply side of the labour market, not on the demand side. That is, it does not create jobs; it tries to influence the job-acceptance behaviour of individuals by raising the effective wage that they receive from working.

The proposed program had the following additional features:

- Eligibility was limited to workers who experienced a permanent job separation after at least three years of continuous employment.

- Supplements were calculated to make up 75% of the difference between earnings prior to EI and earnings in the new job (in calculating earnings losses, pre-EI earnings were capped at the level of maximum EI insurable earnings). However, supplement payments were also capped and could not exceed $250 a week.

- The supplement was time-limited in two ways. First, only those participants who left EI for work within a specified period of time were eligible for supplementation. This maximum job search period was 26 weeks and was measured from the time the supplement was offered to the worker. Second, the maximum supplement eligibility period was 24 months. This period also began when the supplement offer was made at the start of the EI spell. Therefore, participants initially had the choice of trading off job search time for supplement time, up to the maximum permissible job search period.

- Only earnings from full-time employment were eligible for supplementation. Jobs needed to provide at least 30 hours per week to be defined as full-time. Reemployment with the previous employer at the same location was not eligible for supplementation.

Enrolment and Sample Size

For purposes of the project, participants were enrolled over a twelve-month period in each participating CEC (Winnipeg (North and West), Saskatoon, Toronto (Centre), Oshawa and Granby).

Among displaced workers, interest in ESP proved to be high. The overwhelming majority of those who were eligible for the project agreed to participate. A total of 8,144 individuals were enrolled in ESP. Half of the sample was randomly assigned to the supplement group and half to the control group. These two groups were virtually identical at random assignment. Thus, they provide a valid basis for measuring the impacts of ESP. Furthermore, they represented a variety of displaced workers and labour market conditions. Hence, ESP findings for displaced workers are broadly generalizable, even though they are not based on a representative national sample.

Roughly 3 out of 10 supplement group members qualified to receive supplement payments by quickly finding a new full-time job that paid less than their previous one. Seven out of 10 of these supplement qualifiers received supplement payments and those with the highest expected payments were the most likely to receive them. Therefore, 2 out of 10 supplement group members received supplement payments. On average, supplement recipients were paid $8,705 for 64 weeks of full-time employment during the two-year supplement receipt period. About 44 percent of all recipients were still receiving payments when their supplements expired at the end of the two years.

ESP Impacts

- ESP produced a modest increase in full-time employment: the program increased the percentage of displaced workers who became re-employed full time during the six months ESP job search period by 4.4 percentage points.

- However, 15 months after random assignment, average earnings for program participants were 4.6 percent lower than those of the control group, suggesting that the program might have induced a few supplement group members to take lower-paying jobs than they would otherwise have.

- ESP had virtually no effect on the amount or duration of unemployment benefits received by supplement group members. The estimated program impact on average weeks of unemployment benefit payments during the first 15 months after random assignment was 0.2 weeks or 0.9 percent.

- ESP produced a modest transfer of resources from the Canadian government (taxpayers) to the 2 out of 10 displaced workers who received supplement payments. On average, supplement group members experienced a small financial gain of $569 during the first 15 months after random assignment. This was because the supplement payments they received exceeded the earnings loss they incurred and their unemployment benefit payments were virtually unchanged. While this small average gain did not reduce the level of economic hardship experienced by the whole program group, the large supplement payments made to the small fraction of displaced workers who received them were an important source of temporary income for this subgroup.
- ESP produced a net financial cost for the Canadian government of $1,340 per supplement group member during the first 15 months after random assignment. This occurred because supplements paid did not reduce unemployment benefits paid. Accounting for increased income taxes received on the additional $1,340 would reduce somewhat this net financial cost to the Canadian government.

Insights from Focus Groups

As part of this demonstration project, a series of focus groups were held mid-way through the displaced workers’ 26-week job-search period. to gain a better understanding of what workers actually thought of the supplement offer and the role it played in their efforts to find new work.

- Workers were devastated by their job loss and were affected not only financially, but also on a deep, personal level.

- Generally speaking, results indicate that these workers were very anxious to get back to work and, while most would prefer to find work equivalent to that they had, both in substance and pay, the supplement offer was seen as an attractive cushion.

- At the time the groups were held, most had come to the conclusion that it was a pretty tough job market and that they would need to consider different and lower paying work. They said that while the supplement did not make them search any harder, nor make them begin searching earlier, it did expand the scope of their search, allowing them to consider entry level jobs in their own, or other, fields.

- Virtually, all participants said relocating was not an option.

- Financial pressures motivated individuals to finding a new job, and finding it as soon as possible. But getting back into the workforce was also integral to self-identity and self-esteem.
- Older participants particularly worried about their age as a potential barrier to their re-entry.

Earnings Supplementation as a Policy Response

The ESP provided rigorous evidence that offering an earnings supplement to displaced workers would not drastically improve their labour market outcomes. Although results of the experiment showed that the approach made a difference in accelerating return to work, the impact was rather small.

The fact that participating displaced workers showed a strong interest in the supplement offer but that supplement take-up rates ended up being rather low (2 out of 10 participants) may reflect the difficulties participants had in finding new employment. Indeed, the first condition to qualify for the supplement was to find a job. Six out of ten program group members did not find a job in time (within 26 weeks) to qualify for the supplement. If earnings supplements are offered in a labour market environment where there are few jobs available, even low paying jobs, then the chances of success of such policy will be slim.

Are there reasons to believe that results would be different 15 years later? It is hard to tell. The Canadian economy was doing well during the time the ESP experiment took place (1995-1996) and the average unemployment rate compared fairly well with today's unemployment situation. That said, Canada is engaging in a period where labour shortages are expected to be a feature of the labour market for at least a couple of decades, due to the aging of the population. All other things being equal, labour market conditions should be generally favourable in coming years and make it easier for displaced workers to find new employment and make use of such supplement.

Furthermore, it is important to specify what would be the main policy objective of such a program. If the main objective is to accelerate labour market re-entry and save on EI payments, ESP indicated clearly that government should not expect major changes from the introduction of such a program. However, if the main policy objective is to provide financial compensation to displaced workers who have to bear a disproportionably higher share of the costs of economic adjustment, then a program of earnings supplement may be quite successful if it is well targeted. As was mentioned above, the supplement was quite effective in cushioning the shock associated with displacement for those who could benefit from it. It contributed to remove much anxiety for those involved.

Increasing the Effectiveness of the Program

Based on experience with ESP and with the Self-sufficiency project earlier, it is clear that designing an effective earnings supplement program is not a simple matter. The first step should be to define the main policy objective clearly. The design and target groups for the program will differ according the objectives being pursued.

Who should be eligible for a supplement? If the policy objective is quicker re-entry, one should focus on individuals or group of workers who are most likely to experience difficulties in returning to the labour market: unemployed workers unwilling to accept the wages associated with the job opportunities available to them; workers who were in high paying jobs because of seniority or highly specific skills, but with low education and little transferable skills, and older workers for whom the prospect of retraining has little appeal or is simply not viable. If the policy objective is to compensate certain workers for the losses they incurred as a result of economic readjustment, then one option to reduce costs would be to restrict eligibility to certain sectors of the economy experiencing readjustment (e.g. forestry, pulp and paper) or, more specifically, to situations of mass lay-offs.

When should the supplement offer be made? Again, if the policy objective is quick re-entry, the earnings supplement should be offered early—for example, at the start of an employment insurance spell as was done in ESP—in order to hasten reemployment and avoid the scarring effects of prolonged unemployment. Such an early intervention would also increase the likelihood of cost savings—for example, reduced EI payouts to those who leave EI for work more quickly—and would offset some of the costs of the supplement, thereby increasing the potential for the program to be cost-effective. However, intervening early, before people have demonstrated their ability or inability to become employed relatively quickly on their own, means that the program will have a high deadweight cost associated with paying people to do what they would have done anyway. And, if the financial incentive is generous and it is relatively easy to get (for example, after spending only a short time unemployed and receiving EI), then the program could produce a significant entry effect (people who would not otherwise have sought EI benefits may now apply in order to become eligible for the earnings supplementation feature).

On the other hand, if the offering of the supplement is delayed in order to reduce entry effects and so that the program can be targeted on the longer-term unemployed who demonstrate that they most need help, then the government has to bear any costs that are associated with these people remaining unemployed (*e.g.*, payment of EI benefits for a longer period of time). And, if people *do* experience a scarring effect, then the supplement program may ultimately be ineffective because, by the time the offer is made, participants are unable to attract a job offer; or the costs of the program may be much higher than otherwise because the wages that participants can command at that point are much lower than if they had been induced to take a job earlier in their unemployment spell.

How generous should the supplement be? Changing people's behaviour through a program that supplements their earnings requires a number of complicated design issues to be considered in order to have some effect but without breaking the bank. Ideally, the program should offer each person a financial incentive that is just large enough to bring about the desired change in behaviour—not so small that it has no effect, not so large that most of the payment is a windfall gain to the participant. In the real world, however, such precision is unachievable. Incentives cannot be individually-tailored, not just because it is impractical in terms of program delivery, but also because it is impossible to know *ex ante* what size of incentive each person requires.

Decisions on supplement generosity need to be based on some assessment of how much is needed to induce the desired behavioural change. If the supplement is competing with other income transfers then the offer has to be more attractive than these other forms of assistance

If the principal objective is to encourage people to act quickly once the program has been offered, then the offer should be time-limited. Such time-limits also reduce deadweight cost by decreasing the number of people who could receive a supplement simply for going to work when they would eventually have chosen to do so anyway. One may also want to consider a formula which sees the value of the supplement decline over time—either a gradual decline in the value of the offer to encourage people to take it up quickly when it is worth most; or a gradual decline in the amount of the supplement once it is being received, to encourage people to seek earnings gains to replace declining supplement payments or to avoid the sharp drop in income that can otherwise occur at the end of the supplement period. This latter option would be particularly interesting in the case where the main policy objective is to compensate displaced workers for their losses.

Complementing with other services? Although earnings supplements are essentially financial incentive programs, we know that, at least in the case of a previous demonstration project also conducted in the 1990s, the Self Sufficiency Project Plus, providing some additional services or supports can significantly increase the proportion of the targeted clientele who will take advantage of the offer. Therefore, program designers need to consider whether anything other than a straight financial incentive should be offered. For example, in ESP, it might have made sense to make the supplement offer to displaced workers conditional on them receiving job search training or participating in a job-finding club. Since most long-tenured workers do not have recent job search experience, providing job search assistance hand-in-hand with the offer of financial assistance might increase the number of displaced workers who are able to find jobs. It might also help them find better jobs, which would reduce earnings losses and, therefore, reduce supplement cost. If assisted job search is really effective, it might even reduce the proportion of displaced workers who experience any earnings loss at all. In this case, the effective treatment is really job search help, which would probably be much cheaper than an earnings supplement, and the offer of a financial incentive is primarily an inducement to get people to participate in the assisted job search activity.

Alternative EI Options

The relative merit of introducing an earnings supplement program for displaced workers should be evaluated against other types of interventions that could also be offered to displaced workers. Re-training could represent an interesting alternative for workers with solid foundation skills and with several years of working life ahead of them. Work-sharing is another example of policy that could help attenuate the problems of displaced workers by reducing the incidence of displacement and by acting as an advance notice to those who are likely to be let go.

To conclude this presentation, we offer a few suggestions on how the EI system could be amended to address issues associated with displacement. They are classified into large categories, according to the policy objective being pursued.

1. Enriching the Benefits

Improving the benefits that are paid to long-tenure displaced workers could help redress the current imbalance in the EI program whereby long-term premium-paying infrequent claimants receive relatively less in financial support from the program compared with those who have a more sporadic attachment to the labour force and who have much more frequent recourse to the income support afforded by EI.

Increasing the Basic Replacement Rate

Under current EI provisions, higher premiums paid (based on higher earnings) insure access to a higher level of benefits, at least up to the Maximum Insurable Earnings (MIE). The concept of “insured earnings” could be expanded based on the notion that *longer periods of premium payments* should also result in more benefits.

Two alternative formulations could be considered:

a) Increase the basic replacement rate above the current 55 per cent maximum level. Among OECD countries, Canada’s basic replacement rate is among the lowest. It could be increased to a new maximum of, for example, 66 per cent for long-tenure displaced workers..

b) Leave the basic replacement rate unchanged but increase the MIE amount used in calculating the weekly benefit entitlement for displaced workers according to years of participation in the regime. For all workers, one year of premium payments at or above the MIE would be deemed to insure $40,000 of earnings. However, for displaced workers three years of premium payments are deemed to have insured an additional $10,000 of earnings (therefore maximum insured earnings are $50,000) and five years of premiums would call for an additional $20,000 of earnings (maximum insured earnings of $60,000).

   Displaced workers with pre-displacement earnings of $50,000 would receive a 55 per cent effective EI replacement rate compared to the 43 per cent provided by current provisions. Similarly, displaced workers with at least five years of work history who had pre-displacement earnings of $60,000 would receive a 55 per cent earnings replacement rate compared to the 37 per cent provided by current provisions.

Extended Benefit Duration

The EI program currently adjusts benefit duration to take into account local (EI Economic Region) unemployment rates. This system makes the simplifying assumption that all workers in a region are equally affected by the regional level of unemployment. However, at least some displaced workers may be at a competitive disadvantage in seeking jobs (due to their long-term attachment to a single firm/industry that may be in decline or their lack of recent job search experience).

Increasing the maximum length of time that long-tenure displaced workers can draw EI benefits would recognize the potential adjustment difficulties they face. Paying EI premiums for a year would qualify an unemployed worker for the current maximum of 36 to 45 weeks of benefits (depending on the Economic Region unemployment rate). However, paying premiums for three years or more years without a claim would entitle displaced workers to an additional period of “adjustment assistance” benefits.

The extended benefit period could be a fixed number of weeks (e.g. 10 weeks, which would increase the maximum duration to 46–55 weeks for displaced workers — depending on the regional unemployment rate). Alternatively, the extended benefit period could be a percentage of the current maximum duration in the relevant Economic Region (e.g. a 25 per cent increase, which would increase the maximum duration to 45–56 weeks for displaced workers).

Bill C-50 already provides a temporary extension, up to 20 weeks, of Part I benefits to unemployed long-tenured workers. But this policy could be transformed into a permanent feature and/or could be restricted to mass lay-offs situations.

A Flexible Benefit — Benefit Amount or Benefit Duration

A flexible adjustment benefit would be based on the notion that displaced workers with no recent EI claim history merit some additional financial assistance in return for the premiums they have paid, but individuals' needs will vary and they should be given some flexibility to choose a benefit package that meets those differing needs.

The "adjustment benefit" would be calculated as a percentage of a claimant's maximum entitlement. The claimant would then be free to request that this adjustment benefit be provided either in the form of an increase in the weekly benefit amount with the duration of benefit entitlement unchanged, or in the form of an increase in the maximum number of weeks of entitlement at the weekly benefit rate that would normally be payable.

If, for example, the adjustment benefit was set at 25 per cent of the claimant's weekly benefit amount times the maximum benefit duration), then the claimant could request:

- either that the amount of weekly benefits be increased by 25 per cent and this amount would be payable for up to the maximum number of weeks to which the claimant would otherwise be entitled

- or that the maximum benefit duration be increased by 25 per cent with no change in the weekly benefit amount.

[Note that one could imagine allowing a claimant to vary these parameters during the claim period so long as the maximum amount of the adjustment benefit was not exceeded. However, this would unduly increase the level of administrative complexity.]

By way of illustration, consider the two extreme cases. On the one hand, consider a worker who had been working full-time, full-year at not much more than the minimum wage (say, $7.50 an hour for 40 hours a week) in a low-unemployment region. This individual would normally be entitled to a weekly benefit of $165 for a maximum of 36 weeks. On the other hand, consider a worker who had been earning the maximum insurable earnings (or more) in the highest unemployment region. This individual would normally be entitled to a weekly benefit of $423 for a maximum of 45 weeks.

The low-wage displaced worker could elect either to increase the weekly benefit to $206 with no change in the maximum duration or to continue to receive $165 a week but for up to 45 weeks. The high-wage displaced worker could elect either to increase the weekly benefit to $529 with no change in the maximum duration or to continue to receive $423 a week but for up to 56 weeks.

Displaced workers would likely opt for higher weekly benefits if they think they can become re-employed relatively quickly (i.e. foresee little likelihood of exhausting benefits) or if they anticipate having difficulty in meeting their financial obligations with the normal level of EI benefits (either because the benefit amount is low or because they had high pre-displacement earnings, i.e. above the MIE, and are therefore receiving a low earnings replacement rate). Those who anticipate a lengthy period of job search and, therefore, risk exhausting their EI benefits, would likely elect a longer maximum period of benefit receipt.

2. Accelerating Re-employment

While the measures proposed in the preceding section seek to increase the generosity of EI entitlements for long-tenure displaced workers relative to frequent claimants, several measures could be introduced to provide additional incentives for displaced workers to accept available jobs and return to work faster. These can be introduced in tandem with some of the measures described above to counteract any potential negative effects on job search efforts that could result from the availability of enriched benefits. Or they could be introduced on their own if the policy focus is to reduce the length of unemployment spells and prevent long-term unemployment. Note that these measures presuppose the existence of healthy labour markets, where the demand for labour is generally strong.

Re-employment Bonus

This measure would consist in providing a bonus contingent on re-employment within a specified eligible time period during the benefits period. The bonus would also be contingent on a specified employment duration being achieved following hiring. If the bonus is generous enough, it is believed that it may induce some greater effort in job search, thereby shortening the average duration of an unemployment spell.

The size of the bonus, the length of eligible qualification period and the duration in employment following hiring are all parameters that would need to be determined with a view to ensure the intervention provides the right incentive to affect behaviour while minimizing windfall gains.

A certain number of re-employment bonus experiments have been conducted in the United States. The Illinois Re-employment Bonus paid $500 to clients who found work within 11 weeks. The program had mixed results: less than 14 per cent of program group members received a bonus payment and the program reduced average duration of unemployment insurance benefits by 1.15 weeks. This impact was however enough to pay for the cost of the program. Subsequent experiments, conducted from 1986 to 1989 in New Jersey, Pennsylvania and Washington State, had smaller effects or no effect at all.

Declining Payment Schedule

Weekly benefits could be structured in such a way that weekly EI payments decline over time. The overall stream of payments over the period of entitlement would amount to the same as they would have been otherwise, with payments being much larger at the beginning of the period and falling below the normal weekly benefit rate in the second half of the benefit period. It is believed that the probably of accepting a job offer would increase with the declining expected future EI benefits. Past experience suggests that reservation wages decline with duration of unemployment. A declining benefit rate may accelerate changes in the reservation wage and result in shorter duration of unemployment spells.

Personal Re-employment Accounts

Displaced workers could be offered Personal Re-employment Accounts at the very beginning of their benefits period. Personal Re-employment Accounts are personally managed funds that eligible unemployed workers can use to purchase intensive career, job training and supportive services and products from public service providers, the private sector, or a combination of the two. These accounts would be provided in addition to eligibility to regular EI benefits. Implemented on an experimental basis in the U.S., PRAs are given to EI claimants who are judged to have a high probability of exhausting their claims. In some cases, current exhaustees are also eligible.

Each eligible participant is provided with an account that can be used for three purposes:

a) Job search and re-employment supports: PRAs can be used to purchase "intensive services" and other supports that are related to job-search or re-employment. Examples include career counselling, child care, transportation, health-related assistance, and financial management counselling. A wide range of services can be bought from public or private sector providers. Note that account holders must use PRA funds to pay for government services that are provided free to non-account holders.
b) Individual Training Accounts: PRAs can be used for training from any eligible public or private training provider in a way similar to the Individual Training Accounts (ITAs) that are currently offered in many states.
c) Re-employment bonuses: If a PRA account-holder finds a job within 13 weeks, they can withdraw the account money as a bonus for quick re-employment. Sixty per cent of the bonus is paid immediately upon re-employment and the remaining 40 per cent is paid after six months of job retention.

PRAs empower individuals by giving them access to a fixed amount of money and giving them substantial choice and responsibility for its use. PRAs attempt to balance effectiveness and equity by targeting potential EI exhaustees in the hope that PRAs will be effective in promoting employment for this particular group. To identify potential exhaustees, however, requires the profiling of EI claimants, which is not a simple task. O'Leary, Decker and Wandner (2003) and Black et al. (2003) used client characteristics and statistical techniques to distinguish between potential exhaustees and non-exhaustees at the beginning of a claim. Both groups of authors had only limited success in doing so.