

How should job displacement wage losses be insured?

Wage losses upon re-employment can seriously harm long-tenured displaced workers if they are not properly insured

Keywords: wage insurance, job displacement, severance pay

ELEVATOR PITCH

Job displacement represents a serious earnings risk to long-tenured workers through lower re-employment wages, and these losses may persist for many years. Moreover, this risk is often poorly insured, although not for a lack of policy interest. To reduce this risk, most countries mandate scheduled wage insurance (severance pay), and it is voluntarily provided in others. Actual-loss wage insurance is uncommon, although perceived difficulties may be overplayed. Both approaches offer the hope of greater consumption smoothing, with actual-loss plans carrying greater promise.

KEY FINDINGS

Pros

- + Actual-loss insurance is the theoretical ideal, promising complete smoothing of consumption following job displacement.
- + Tenure-linked severance pay serves as scheduled wage insurance, helping offset re-employment wage losses.
- + Savings accounts may provide an alternative to insurance if the latter's inherent moral hazard problems are severe.

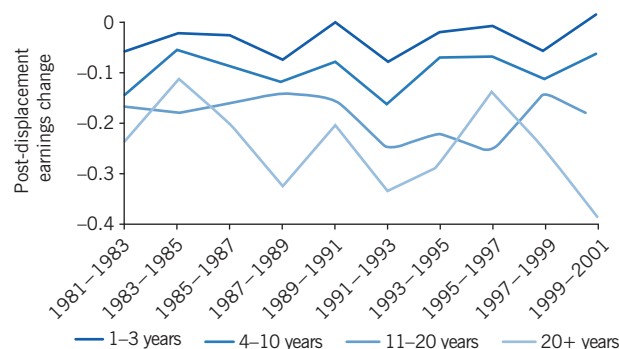
Cons

- Theoretical concerns about actual-loss insurance are manifold, and include measurement and moral hazard concerns.
- Tenure-linked severance benefit schedules only crudely track actual wage losses.
- Improvement in severance benefit schedules, say by introducing additional loss factors (e.g. general economic conditions), might be difficult.
- Savings accounts are inferior to insurance if, as with job displacement of long-tenured workers, the event involves a small probability of a large loss.

AUTHOR'S MAIN MESSAGE

Lower re-employment wages following job displacement are a major concern in flexible wage economies; many countries address this issue by mandating scheduled benefit plans (severance pay). Potential problems with actual-loss wage insurance are easy to enumerate, but available, although limited, evidence suggests that these problems may be overstated. Ways of improving scheduled wage insurance are easy to identify, e.g. linking benefits to business cycle conditions, but may be hard to implement. The promise of performance efficiency in actual-loss plans argues for additional demonstration projects and small-scale testing.

Earnings change of displaced workers by tenure, US



Source: [1]; Table 3.

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