

FRESH PERSPECTIVE SERIES

**Security Accounts
as Short Term
Social Insurance
and Long Term
Savings**



THE ASPEN INSTITUTE
FUTURE OF
WORK
INITIATIVE

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ABOUT THE FRESH PERSPECTIVE SERIES

THE FRESH PERSPECTIVE SERIES is a collection of independent works from expert authors across the ideological spectrum, each presenting new ideas for how various aspects of the social safety net could be updated to better meet the needs of our 21st century workforce. The economic landscape is changing far faster than our system of workplace protections and benefits has been able to keep pace – requiring fresh ideas for how to revitalize our social contract and restore the promise of work. The Future of Work Initiative is committed to the goals of promoting new and creative thinking, sparking bipartisan policy discussion, and working together to help create a healthier economic climate for all stakeholders. The ideas and proposals included are those of the authors, with editorial support from Future of Work Initiative staff.



Security Accounts as Short Term Social Insurance and Long Term Savings

EXPANDING FINANCIAL
SECURITY FOR WORKERS IN
THE NEW ECONOMY

By Jonathan Gruber, MIT

INTRODUCTION

OVER THE PAST CENTURY, the United States has developed a sophisticated set of Social Insurance programs that provide vital support to workers suffering through the vagaries of our economy. These include programs that provide support for short term work displacement, such as Unemployment Insurance and Workers' Compensation as well as programs that provide support for a permanent inability to work, such as Disability Insurance and Social Security. These programs have been supplemented by optional employer-provided benefits to provide long term security, such as private pensions.

The current set of insurance programs suffers from four problems as we transition to an on-demand economy. First, the growth of contract workers threatens the ability of workers to benefit from existing short-term social insurance programs. Second, employers have been providing less generous insurance against retirement, either by replacing defined benefit plans with define contribution plans or dropping pensions altogether. Third, existing short-term social insurance programs, where benefits receipt is tied to being off the job, provide strong incentives for workers to stay off the job until their benefits are exhausted, leading to higher program costs and a less productive workforce. Fourth, the social safety net covers only a targeted set of financial risks that may not provide the cushion that workers need for the broader economic shocks that they face, such as high medical spending, breakdown of cars or other consumer durables, or off the job accidents that do not lead to disability.

This proposal suggests a joint expansion of the financial security for workers and reframing of short-term social insurance programs that addresses these concerns. The centerpiece would be the creation of self-insured "security accounts" which would simultaneously expand the liquidity available to workers for short term shocks while reducing the short term "moral hazard" due to existing social insurance programs. These accounts would be individual and not firm based which would allow for flexibility in the new economy. These short-term Security Accounts would fold over into a longer run Retirement Account which augment the preparation of workers for their retirement years.

This is a very broad proposal which raises a host of questions about the specific design of social insurance programs. But it provides a framework for moving forward with our nation's social supports in an era of economic transition.

SHORT AND LONG TERM FINANCIAL CHALLENGES FOR WORKERS

AN INEFFICIENT AND DIMINISHING SHORT-TERM SAFETY NET FOR WORKERS TODAY.

The social insurance safety net has two key short run “nodes”.

Unemployment Insurance

The first is Unemployment Insurance (UI), which pays workers a weekly benefit for a specified period of time if they are laid off from their job. The U.S. state and federal government currently pay out about \$70 billion in UI benefits payments per year, although spending peaked at almost \$300 billion in 2010.¹The features of UI are set by each state, but in general workers receive a benefit that replaces about half of their earnings before unemployment, subject to a minimum and maximum benefit level (and subject to income taxation). Benefits last for 26 weeks in normal times, but can be extended in times of economic distress; in the most recent recession, benefit durations for some workers reached as long as 99 weeks.

Economists have long been fascinated by the UI program, and there is a voluminous literature on how it impacts worker and firm behavior. Several conclusions are clear. First, workers who get more generous benefits, or for whom benefits are extended longer, remain out of work longer. This might be beneficial if it results in better job matches, but the evidence suggests that it does not; those workers who stay out of work longer due to more generous or longer duration benefits don't end up with higher wages when they eventually do find a job. This problem of “moral hazard” is viewed as a major inefficiency within UI, leading to both higher UI taxes and a loss of valuable work time.

Second, UI plays a valuable role for workers who face longer term unemployment by allowing workers to maintain their standard of living. For workers with short or



“Unemployment Insurance plays a valuable role for workers who face longer term unemployment by allowing workers to maintain their standard of living. For workers with short or predictable unemployment spells, unemployment insurance has only a small impact on workers’ ability to finance their consumption while out of work.”

¹ http://www.usgovernmentspending.com/us_welfare_spending_40.html

predictable unemployment spells, unemployment insurance has only a small impact on workers' ability to finance their consumption while out of work.

Workers' Compensation

Workers Compensation (WC) is the nation's oldest Social Insurance program, and in normal times is much larger than unemployment insurance. WC provides insurance for workers against the risk of on-the-job injury. The current program spends about \$30 billion each on cash and medical benefits per year.²

Unlike UI, WC is not a tax-financed government insurance program, but rather a mandated form of purchased insurance for employers.³ Employers can purchase insurance from a variety of different private insurers, and in some states from public insurers as well. This insurance must cover a cash benefit schedule mandated by the state; benefits typically replace about two-thirds of pre-injury wages, subject to a minimum and maximum value (and not subject to income taxation). In addition, the insurance covers medical expenses under a fairly generous system that allows much broader choice of health care provider and lower patient costs than a typical group health insurance plan.

There is a much smaller literature on WC than on UI, but it has shown that the incidence and duration of worker injuries responds quite strongly to the generosity of WC benefits. Higher benefits lead to a higher rate of worker injuries and longer durations among those who are injured. Empirical evidence suggests that the problem of "moral hazard" in WC is larger than for UI, with a much stronger response of reported injury durations to WC benefits than unemployment durations to UI benefits.

Problems with These Programs

The existing safety net faces several problems. The first is the one noted above - moral hazard caused by workers responding to generous benefits through reduced work effort. This causes two types of loss for the economy. First, higher taxes or employer-sponsored premiums are required to pay for these programs, which lowers the return to work for other workers and may lead to further reductions in work effort. Second, lower work effort reduces the amount of goods and services that are produced by the economy.

The second problem facing the safety net is the reduced coverage and reach of these

² https://www.nasi.org/sites/default/files/research/NASI_Work_Comp_Year_2015.pdf

³ Workers' compensation is a mandated form of purchased insurance for employers in every state but Texas, where firms can opt out of WC in favor of self-insurance of worker injuries.



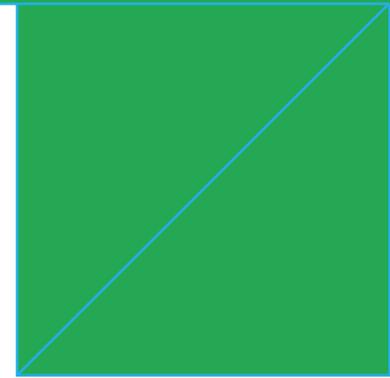
"The existing safety net faces several problems. The first is moral hazard caused by workers responding to generous benefits through reduced work effort... The second is the reduced coverage and reach of these programs as we transition to an on-demand economy."

programs as we transition to an on-demand economy. A large literature on UI has documented the failure of the program to serve the many disadvantaged workers who do not work enough to qualify for coverage. And the definition of a “layoff” is inherently arbitrary for workers whose services are required on an irregular and unpredictable basis. Likewise, the distinction between on-the-job and off-the-job injuries is blurred when more workers are working from their own cars or homes.

The third problem facing the safety net is the limited ability of these programs to broadly secure U.S. workers against short term shocks. Unemployment and on-the-job injury are only two examples of the many shocks that afflict workers in today’s economy. Injuries and accidents unrelated to work that can cause a short term inability to work are not uncommon, and can be devastating to workers whose jobs do not allow flexibility for time off with sick day pay. Large unexpected expenditures such as a major car repair or a large medical expense can exceed the savings of many lower or middle class families.

INSUFFICIENT SAVINGS FOR LONG-TERM PREDICTABLE EXPENSES

Another well-documented problem for workers in the new economy is a lack of savings for longer-term predictable expenses, particularly retirement, but also including major life events like children’s college and home purchases. Workers are of course protected against income loss in retirement by the Social Security program, but traditionally those benefits were supplemented by the availability of employer-provided pensions. Over the past 30 years, however, the provision of pension benefits has declined precipitously. This has prompted calls for a wide variety of employer-based mandated private savings vehicles, as well as changes in the structure of employer-provided pensions to provide “behavioral nudges” in favor of more savings. But these alternatives would not provide coverage for workers outside the traditional employment setting.



“Workers are protected against income loss in retirement by the Social Security program, but traditionally those benefits were supplemented by the availability of employer-provided pensions. Over the past 30 years, however, the provision of pension benefits has declined precipitously.”

INDIVIDUAL SECURITY AND RETIREMENT ACCOUNTS AS AN ALTERNATIVE

The alternative proposed here is simply a conceptual one. Most of the details of such an approach would need to be worked out. As such, any policy details suggested here are best viewed as placeholders within a larger structure.

ACCOUNT FINANCING

- 1) Every worker in any type of work arrangement would have their earnings matched by six cents of contribution to a Security Account (SA) for every dollar that they earn. This obligation would attach to any compensation paid for either regular or contract work. It would be designed to cover all formally compensated labor, regardless of the structure of the employment arrangement.
- 2) These contributions continue until the account has reached the smaller of (a) 6.5 weeks of current wages or (b) 6.5 weeks of the median weekly earnings in the area. This is the MAX.
- 3) The SA would never go above MAX. Once worker contributions exceed that amount, net of withdrawals, then the excess is transferred to a Retirement Account (RA) (described below).
- 4) The SA would be held at a local depository institution earning checking account interest rates.
- 5) SA withdrawals are taxable events

GENERALIZED RULES FOR WITHDRAWALS FROM SECURITY ACCOUNT

The tension with Security Account is between (a) providing a valuable source of liquidity for short-term shocks to workers and (b) simply becoming a transfer to workers that is used for financing every day consumption needs and not true shocks. Resolving this tension will be difficult. But a simple set of rules can help ensure that this balance is met

- 1) SA withdrawal is allowed for a specific list of needs:
 - Major reduction in earnings (e.g. more than a one-third fall in earnings)
 - On the job injury
 - Disability
 - Family or medical leave (as defined by FMLA)
 - A medical bill that exceeds one week's salary
- 2) There will be a host of barriers to withdrawal to ensure that it is used for security only.
 - Individuals will need to apply for a withdrawal 4 days before the money is received, in order to avoid a short-term lack of foresight in using the money
 - Withdrawal will require affirmative confirmation that it is for one of the associated reasons with penalties for withdrawal for other reasons
- 3) Withdrawals are limited to a maximum of 16% of MAX over any two week period. This is designed to trade off need for liquidity versus over-optimism of need for future balances and to ensure that balances last 13 weeks.
- 4) After 13 weeks, workers transition from their SA accounts to social insurance programs, under details provided below.
- 5) Workers who are below the MAX in their SA accounts but who qualify for withdrawal under one of the conditions above may transition earlier to social insurance programs, subject to some program specific rules below.

CHANGES TO SHORT-TERM SOCIAL INSURANCE PROGRAMS

The introduction of the Security Account would allow the possibility of reform of the existing UI and WC programs that would address the program deficiencies noted above.

- 1) Workers must document layoff or on-the-job injury (as in today's system) and have exhausted their SA before qualifying for UI or WC payments.

2) WC benefits are now fully taxable, as is true currently with UI benefits and would be true of SA payments

RETIREMENT ACCOUNTS (RA)

Another advantage of this approach is that it provides a natural mechanism for extending the savings of workers who do not have access to traditional workplace savings plans. As noted above, once the amount in the SA account reaches MAX, additional contributions would be made to a Retirement Account (RA). The RA would be held in a low cost age-specific index.

RA withdrawals would be allowed without penalty only for home, major medical (more than 10% of annual income), higher education, or retirement spending

FINANCING

- 1) Government would finance SA (and ultimately RA) on a progressive basis. For workers earning less than \$25,000, the government would contribute the entire 6% of earnings. This would phase out until the government is contributing nothing at earnings of \$100,000 or higher.
- 2) The additional financing into the SA would come from individuals and employers, at their discretion (as with other employee benefits). Individual contributions to the SA would be pre-tax.
- 3) Employers are always able to add more generous benefits if they like, e.g. offering paid maternity leave that does not require a drawdown of the SA.
- 4) The government would end non-contributory IRA contributions for individuals, would end rollovers of individual into Roth IRAs, and would limit total tax preferred total workplace 401(k)/defined contribution pension contributions to \$10,000 per year (in addition to the SA contributions that may get rolled over into RA)

Example

Suppose that Bruce earns \$52,000 per year, and the median worker earnings in his area is \$40,000 per year. His weekly salary is \$1000, so each week \$60 is set aside into his SA. This continues until he has \$5000, which is 6.5 weeks of the median worker earning in his area. So after 83 weeks, if there are no withdrawals, the \$60/week contribution goes into Bruce's RA.

Suppose that Bruce starts working on January 1, 2014 at his \$52,000 salary, and he continues to work at that salary through the end of 2015. As of December 31, 2015, he will have \$5000 in his SA and \$2560 in his RA.

Then, unfortunately, Bruce loses his job on January 1, 2016. At that point, he is eli-



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gible to withdraw funds from his SA, up to 16% of his \$5000 maximum, or \$800 each two weeks. This allows Bruce to replace 40% of his pre-unemployment earnings. This withdrawal is a taxable event, as is his earnings.

Suppose that Bruce is unable to find a job for 13 weeks. At that point, his SA is exhausted, and he transitions to the state's unemployment insurance system, where he is provided benefits for 26 more weeks.

Once Bruce finds a new job, he begins to again contribute to his SA. Once he has fully funded his SA again, his "overflow" contributions will flow into his RA.

As a typical example, suppose that Bruce flows only \$2560 into his RA every two years from age 21 until age 40, and then from age 40 only his entire annual \$3120 contribution flows into his RA (ignoring inflation for these purposes). Suppose also that Bruce earns a 3% return on his investment in his RA. Then by the time Bruce is age 65, he will have \$185,000 in his RA.

BENEFITS OF THIS APPROACH

This approach offers a wide variety of benefits. Most importantly, it recognizes the fundamental tradeoff with Social Insurance programs: they are designed to provide support for falling consumption during periods of economic shock, but in doing so they encourage individuals to leave work in order to take advantage of the benefits. By replacing social insurance with self-insurance, this proposal can reduce the economic inefficiencies while at the same time ensuring that resources are available to insure workers' standard of living. And by maintaining the underlying social insurance infrastructure for workers whose shocks exceed their SA accounts, the program will redistribute towards those who have highly volatile earnings and those who have longer spells of joblessness or injury.

Second, the new system recognizes the holes that are opening up in our social insurance system in the new economy. An increasing share of the shocks that face families are not tied explicitly to layoffs or on-the-job injuries. Yet families don't have the resources to meet these demands. The SA would provide those resources.

Third, this progressive system recognizes the higher volatility and need for financial support faced by lower-income families in the U.S. For higher income families, this program will likely simply replace savings that they were doing on their own for uncertainty or retirement. But mandatory savings has been shown by previous research to not simply crowd out savings for low and middle income families but to instead raise their total security and retirement savings cushions. Existing economic evidence shows clearly that such a system will raise total savings in the U.S., providing a valuable pool of savings that firms can draw on to finance investment.

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Dr. Jonathan Gruber is the Ford Professor of Economics at the Massachusetts Institute of Technology, where he has taught since 1992. He is also the Director of the Health Care Program at the National Bureau of Economic Research, and President of the American Society of Health Economists. He is a member of the Institute of Medicine, the American Academy of Arts and Sciences, and the National

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During the 1997-1998 academic year, Dr. Gruber was on leave as Deputy Assistant Secretary for Economic Policy at the Treasury Department. From 2003-2006 he was a key architect of Massachusetts' ambitious health reform effort, and in 2006 became an inaugural member of the Health Connector Board, the main implementing body for that effort. During 2009-2010 he served as a technical consultant to the Obama Administration and worked with both the Administration and Congress to help craft the Patient Protection and Affordable Care Act. In 2011 he was named "One of the Top 25 Most Innovative and Practical Thinkers of Our Time" by Slate Magazine. In both 2006 and 2012 he was rated as one of the top 100 most powerful people in health care in the United States by Modern Healthcare Magazine. Dr. Gruber is the Chair of the Industry Advisory Board for Flare Capital Partners, and is on the board of the Health Care Cost Institute.



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