THE HAMILTON PROJECT

Advancing Opportunity, Prosperity, and Growth

Retraining Displaced Workers

For workers displaced in mass layoffs and plant closings, the consequences of being laid off usually extend far beyond the period when they are unemployed. When they do find new jobs, they face substantial and highly persistent declines in their earnings. On average, these workers experience losses equivalent to about 25 percent of their previous earnings—even five to ten years after the displacement occurred. Earnings losses of displaced workers are not related to national

Retraining Displaced Workers

POLICY BRIEF | OCTOBER 2010

economic growth but rather to waning demand for a certain set of job- or industry-specific skills. Workers who possess skills in declining industries or sectors experience lower earnings, even after they are reemployed full time and even in expanding job markets, because their old skills are often difficult to transfer to emerging and growing sectors.

Robert LaLonde of the University of Chicago and Daniel Sullivan of the Federal Reserve Bank of Chicago suggest that retraining through our nation's community colleges is a way to reduce the skills gaps of at least some of these displaced workers and increase their reemployment earnings. Although workers may still experience significant earnings losses relative to their previous positions, training can be a socially desirable investment that can help trim these losses, and can have positive effects on their communities. This is an important form of social insurance for workers who experience earnings losses due to structural changes in the economy. In addition, workers may underinvest in training due to credit constraints, poor information about returns, and/or because some of the benefits accrue to society through tax receipts and lower social insurance payments.

The authors' proposal would increase the quantity and quality of retraining by increasing Pell Grants for training-ready displaced workers, augmenting funding for community colleges so that states and localities do not cut budgets when demand for retraining is increasing, and reforming funding mechanisms so that more money is directed toward vocational training programs that produce higher returns for displaced workers. The authors also recommend that the Departments of Education and Labor both facilitate the development of standard curricula for retraining displaced workers and evaluate community college and privately provided programs.

The Challenge

Worker Displacement and Its Effect on Communities

Displaced workers are a specific type of job loser whose job loss resulted from a plant closing, a position being eliminated, insufficient work, or a similar reason. These workers tend to experience large decreases in earnings on reemployment. These earnings losses are not just from changing industries—one study of workers displaced in Pennsylvania during the 1980s showed that workers who found jobs within the same industry still experience long-term earnings losses of more than 15 percent. Workers who moved from the manufacturing industry experience some of the largest losses—about 40 percent, on average.

Such large earnings losses occur because displaced workers possess skills that were specific to their previous job or industry, such as knowledge of the company or niche product markets, or even knowledge of coworkers that helps workers perform better in their jobs. These skills were highly valuable in their previous job, but are not in their new job. Because workers build up firm- and industry-specific skills as their time in a job increases, earnings losses are largest for longer-tenured workers. According to the Bureau of the Census's Displaced Workers Surveys, workers with four to ten years of tenure in their prior job experience earnings losses of about 5 percent, on average. For workers with between ten to fifteen years in their previous jobs, average earnings losses amount to 15 percent. For workers that had more than twenty years of tenure, average earnings losses are more than 30 percent.

The effect of the permanent elimination of a job—and of job-specific skills—is different from the usual types of unemployment, which are generally temporary and have only transitory effects on a worker's income.

The effect of the permanent elimination of a job—and of job-specific skills—is different from the usual types of unemployment, which are generally temporary and have only transitory effects on a worker's income. For displaced workers, temporary programs like unemployment insurance do not address the long-run earnings losses these workers face.

Failures of the Worker Training System

The problem for displaced workers is how to address long-run earnings losses. One solution explored in previous Hamilton Project discussion papers is to offer wage insurance—a program that helps to make up part of the difference between a worker's new earnings and the earnings from a previous job. A second-best option in Sullivan and LaLonde's view is to boost workers' earnings directly by investing in their skills through retraining. Retraining can imbue some displaced workers with new skills that are in greater demand and can reduce their earnings losses.

Although federal programs for retraining displaced workers exist, federal funding for training represents only a small portion of total expenditures for displaced worker retraining. Most people pay for their own training at either private schools or at community colleges subsidized by state and local governments. Recent changes in the U.S. Department of Education's Pell Grant program may provide additional federal support for retraining displaced workers, at least while those workers are unemployed. However, this system has a number of weaknesses that result in a lower quantity of training overall and a mix of training programs different from what is optimal.

The authors of this Hamilton Project discussion paper, along with Louis Jacobson, conducted the most comprehensive examination to date of the costs and benefits of training for displaced workers. In this research, they found that the private returns were significant—on average, an academic year of community college training increased workers' earnings by about $800 per year—but most workers only trained for about half of one academic year.

There are many reasons why workers may underinvest in retraining. First, the unemployed may lack access to funding to pay the upfront costs of training. This causes workers to underinvest in training relative to the benefits they can gain. Second, unemployed workers may not have good information about the returns to undertaking training programs. Third, some of the benefits of retraining go to others through higher income taxes and lower receipt of social insurance.

The research of Jacobson, LaLonde, and Sullivan indicates that not all training programs are created equal. Training in more technically oriented fields such as math or science and training in healthcare fields have returns that almost offset the earnings losses of displaced workers. Returns were about $1,600 per year compared to only $800 per year for other training, on average. By subsidizing the most beneficial programs, the federal government could reduce the costs for these programs and increase demand and usage among the unemployed of these higher-value programs.

Third, community college funding tends to decline during recessions when state and local governments reduce spending on education and other services because of losses in tax revenue. At the same time, however, demand for retraining is rising, leaving many without access, especially in more valuable and more expensive courses like those in healthcare services.

Not only is there higher demand during recessions but recessions also are the period when training is likely to be most cost-effective. A large part of the cost of training and education is in forgone earnings while workers are in these programs. During a recession, though, when jobs are scarce, many of the workers likely would not find jobs anyway, lowering the opportunity cost of forgone earnings.

The problem for displaced workers is how to address long-run earnings losses.

A New Approach

Authors LaLonde and Sullivan present six integrated proposals to correct weaknesses in the current training system for displaced workers, increasing both the quantity and the value of training. The authors' proposals and their arguments are as follows:

Pell Grants for Displaced Workers Program

There is currently no federal support for training reemployed displaced workers. While recent changes in the Pell Grant program allow displaced workers to qualify while they are unemployed, once they are reemployed their earnings would be too high to get much financial aid from the program. The authors seek to correct this exclusion by extending Pell Grant eligibility to employed high-tenured displaced workers whose earnings in a new job are lower than at their previous job.

Workers would be eligible for this program even if they have a bachelor's degree; previous degrees would not affect financial aid under this program. One limitation on eligibility would be the size of the earnings loss experienced: only workers with reemployment earnings more than 5 percent less than their previous earnings would be eligible. This can be viewed as an insurance deductible: workers should save and prepare for modest declines in earnings, whereas displaced workers should receive some compensation for large earnings losses. The program also would have an income cap so that workers with very high income would not qualify for subsidized training. The authors caution against setting the income cap too high, however. A worker who is making $50,000 in a new job may have previously made $70,000 and thus have experienced a drop in earnings of nearly 30 percent. The authors contend that such workers are likely to benefit from retraining because they have higher levels of initial skills compared to low-income displaced workers whose reemployment earnings losses are small.

Training alone is unlikely to eliminate earnings losses entirely—in the long-run displaced workers will have to make changes to their standard of living to adjust. But this extended Pell Grant program can help encourage training, decrease the size of the long-term earnings loss, and reduce the need for more costly adjustments.

…this extended Pell Grant program can help encourage training, decrease the size of the long-term earnings loss, and reduce the need for more costly adjustments.

Recession Community College Fund

Recessions and local economic distress tend to squeeze the budgets that support community colleges precisely when these institutions are needed most. The federal government should provide funds to help ramp up the number of community college programs offered to keep them in line with increased demand for retraining. Without this additional support, the Pell Grants for Displaced Workers program that LaLonde and Sullivan propose will further stress community college finances because state and local governments subsidize community colleges on a per capita per credit-hour basis. If states cut or freeze these subsidies at the same time, the number of enrollees will increase as a result of the incentives implied by the Pell Grants for Displaced Workers program and community colleges will lose money on each new student.

Such a program has many precedents. For example, the federal match for both Temporary Assistance for Needy Families and Medicaid rose during the recent recession to help prevent state cuts to these programs. Similarly, buffer funding for community colleges could be based on movements in local unemployment rates or mass layoffs of large employers.

As it is very hard to expand the capacity of a community college by hiring new teachers quickly, short-term expansion in capacity is easily achieved through the incentive of extra service pay. The recession community college fund should make provisions for extra service pay based on a formula that takes into account the increased student enrollments and the subjects that they enrolled in that are associated with the bad economic times.

Reforming Funding Mechanisms for Community Colleges to Encourage High-Return Courses

Research indicates that courses in technical subjects such as math or science and training in healthcare or vocational fields that emphasize science and math skills have the highest returns. However, these types of courses tend to be undersupplied and enrollment-restricted because state funding formulas for community colleges are usually based on enrollment rather than on the cost of the courses offered. Such funding mechanisms should be changed to recognize the greater expenses often associated with these high-return programs of study. One way to realign the incentives for community colleges to offer higher-value courses is to allow community colleges to charge more for these courses. Through the Pell Grants for Displaced Workers program, workers would still be able to access these more expensive classes.

Targeting Training for Training-Ready Displaced Workers

LaLonde and Sullivan observe that, in the past, retraining has had a mixed reception among policymakers and advocates for displaced workers. Many correctly observe its impacts are often very small, leading some to incorrectly conclude that training does not work. In fact, training does work for some displaced workers; studies document impressive gains in certain circumstances. But many lower skilled displaced workers do not appear to benefit from retraining on average. As a rule of thumb, displaced workers who have already completed some postsecondary education are likely to benefit from retraining, those who require remedial education are unlikely to benefit, and high school graduates fall somewhere in between.

To address the problem that resources are scarce and that retraining can only compensate workers for their losses if it leads to increased earnings, the authors propose restricting access to the Pell Grants for Displaced Workers program to otherwise eligible individuals who are training-ready or nearly training-ready. The authors recommend limiting the use of these funds to the completion of no more than one remedial-level course.

Linking Financial Aid to Performance

Many community college programs and programs operated by for-profit proprietary schools have very low completion rates. These low rates have led to calls for programs that assist students in successfully completing their chosen programs of study, including components that help better match students skills and time commitments to the demands of particular programs. LaLonde and Sullivan do not recommend that financial aid is linked to program completion rates until the reasons for these low rates are better understood and strategies for addressing them have been implemented and tested. Furthermore, they are mindful of the evidence that displaced workers benefit economically even if they complete just a few postsecondary courses.

The authors contend, however, that there are actions that policymakers can take that would likely improve the performance of the proposed Pell Grants for Displaced Workers program. First, they recommend making aid contingent on past performance. So, for example, a displaced worker who started two courses that she did not complete or that she failed would be ineligible for additional financial aid during subsequent semesters until she satisfactorily completed both classes. The authors view this requirement as being consistent with the objective of targeting retraining expenditures toward training-ready displaced workers. Second, they recommend that the institutions that enroll students under the proposed program be required to report electronically on a semiannual basis to federal authorities; included in the report would be courses taken, those successfully completed, certificates or degrees received, and the student's field of study. Software should be developed that would compile this information into a convenient database that prospective displaced workers could use to track how well their peers had done at different institutions.

Dissemination and Evaluation

There is little research that sheds light on the type of training that is most appropriate for displaced workers or which training providers (community colleges or proprietary schools) have the highest return. Although the research we have seen suggests that technical training is a better investment, the types of workers that choose these training programs may have previous education or personal characteristics that make this training of higher value for them in a way that it would not be for others. Further research on and evaluation of models to steer displaced workers to higher-value training is also needed.

The U.S. Department of Education, along with the U.S. Department of Labor, should take a lead in evaluating training programs for displaced workers. The authors call for the creation of a commission within the Department of Education to develop, where possible, standardized and customized curricula for displaced workers such as those that exist for many executive MBA programs. One attractive feature of these programs is that they are designed for people who are working. This fact is recognized in the design of the curricula itself, the demands those programs make on students' time, and on the times when classes are held.

Retraining ... provides training-ready displaced workers with skills that are valued in a changing economy.

Key Highlights

Authors Robert LaLonde and Daniel Sullivan present evidence that workers suffer large earnings losses after being displaced from their previous jobs. LaLonde and Sullivan argue that retraining is an appropriate way to help these workers reduce their earnings losses. They propose a six-part proposal to increase the quantity and quality of training that displaced workers receive.

1. **Pell Grants for Displaced Workers Program:** Pell Grants would be available to workers that are already reemployed but have suffered substantial earnings losses and want to take classes part-time.
2. **Recession Community College Fund:** The federal government should provide a fund to distressed communities to increase funding for community colleges as demand for training increases.
3. **Reforming Funding Mechanisms for Community Colleges to Encourage High-Return Courses:** Funding mechanisms should recognize that some high-return courses, such as technical and healthcare courses, are more expensive to offer. Funding mechanisms should be changed to recognize the greater expenses associated with such programs of study.
4. **Targeting Training-Ready Displaced Workers:** Policymakers should recognize that retraining will raise earnings of only a subset of displaced workers. Many are not prepared to benefit from modest expenditures on retraining. For those that are prepared to benefit, training can generate impressive social returns. To better target its resources to displaced workers most likely to succeed, the program should (i) limit the use of funds to the completion of no more than one remedial level course and (ii) implement an application process that ensures displaced workers are likely to succeed in their course of study.
5. **Linking Financial Aid to Performance:** Financial aid in the program would be contingent on past performance. The authors also recommend development of reporting requirements for institutions that enroll displaced workers who receive aid so that prospective students can monitor their peers' progress and success.
6. **Dissemination and Evaluation:** The Department of Education should facilitate the creation of standardized curricula for displaced workers, and the Department of Education and the Department of Labor should evaluate the returns to vocational training programs of private for-profit schools and community colleges.

Costs and Benefits

LaLonde and Sullivan observe that their proposed Pell Grants for Displaced Worker program will generate sizeable social benefits only to the extent that policymakers and program operators are able to target financial aid to training-ready displaced workers enrolled in high-return subject areas or programs. In their study, with Louis Jacobson, of displaced workers from Washington State, they found rates of return from such investments to be approximately 12 percent, more than 50 percent greater than estimates of the returns on investments in formal schooling, or most other investments for that matter. This figure even takes into account the costs associated with raising taxes to pay for such training.

Unfortunately, not all displaced workers are prepared to benefit from retraining in high-return subject areas. In that same study of displaced workers from Washington State, the authors found very low returns to many community college programs. There were several reasons for this: First, lower skilled workers did not appear capable of succeeding in high-return subject areas. Second, the courses the workers took sometimes had no effect on their future earnings. Third, older displaced workers simply did not have enough years left in their careers to fully benefit from the training they received. These considerations underscore an important dilemma faced by policymakers: as they expand access to these programs to a larger share of workers, the net social benefits from retraining declines. But by limiting access only to those likely to generate the highest returns, they undercut the program's other objective, which is to compensate displaced workers for their earnings losses.

With the foregoing considerations in mind, LaLonde and Sullivan use the Displaced Workers Surveys to estimate the annual costs of their proposed Pell Grants for Displaced Workers program in good times and in bad. Based on the number of training-ready workers and an average completion rate of one year's worth of retraining, the program would invest up to $2 billion dollars during a recession. By contrast, program expenditures would total about $1 billion during periods of economic expansion.

Questions and Concerns

What policies are available to aid lower skilled and older workers?

The authors do not recommend any changes to the Pell Grant program for unemployed workers, which is open to workers of all skill levels. The Pell Grant has recently been modified to make it more accessible for older workers.

Are the social returns to training positive?

Estimated social returns for training look not only at the private costs and benefits to participants, but also at the benefits of increased tax revenue and reduced social expenditures relative to the full government costs of the training. A substantial amount of evidence indicates that training has positive social returns for economically disadvantaged adult women—for example single women that receive Temporary Assistance for Needy Families or its predecessors. By contrast, these studies rarely find evidence of positive net social benefits from training economically disadvantaged youths that are sixteen to twenty-one years old. Part of the reason the authors call for increased evaluation is the lack of research that exists on the effectiveness of training for displaced workers. The evidence suggests that the returns to training in technical programs appear to be positive, while the returns may be smaller or possibly zero for other programs, and training generally has a larger private and social return for women partly because their forgone earnings are lower, on average.

Conclusion

As the authors recognize, retraining is only one part of a multiple strategy solution for displaced workers and distressed communities. Retraining is a critical element, however, because it provides training-ready displaced workers with skills that are valued in a changing economy. Retraining is unlikely to completely eliminate the earnings losses of displaced workers. But for workers whose previous careers are no longer viable and who would otherwise have earnings losses as high as 30 percent or more, a sizeable reduction in those losses can have significant impacts on their lives, their families, and their communities.

Learn More About This Proposal

This policy brief is based on a forthcoming The Hamilton Project discussion paper, Retraining Displaced Workers, which was authored by:

ROBERT LALONDE
Professor
University of Chicago

DANIEL SULLIVAN
Executive Vice President and Director of Research
Federal Reserve Bank of Chicago

Additional Hamilton Project Proposals

Bringing Jobs to People: How Federal Policy Can Target Job Creation for Economically Distressed Areas

This paper proposes three solutions to bring jobs to distressed areas: Customized job training programs for businesses and employees, advice and consulting services through the Manufacturing Extension Partnership program, and a package of grants for local services and tax breaks through a reformed and revitalized Empowerment Zone program. Built upon evidence from regional economics research, these policies provide investments and incentives that increase employment and productivity in distressed areas. These programs, directed largely to small- and medium- businesses can have large effects on worker productivity and business competiveness, encouraging sustained employment and rising wages. Because these programs offer investments in workers, firms, and local services, they provide a higher return on government spending and are more cost effective than programs that focus on incentives alone.

The Mobility Bank: Increasing Residential Mobility to Boost Economic Mobility

This paper proposes the creation of a “mobility bank” at a government cost of less than $1 billion per year to help finance the residential moves of U.S. workers relocating either to take offered jobs or to search for work, and to help them learn more about the employment options available in other parts of the country. Whereas those with college degrees and savings are much more likely to move in response to job loss and to improve their job market outcomes, those with less skills and no savings may have difficulty financing such transitions. The government should target mobility bank loans toward displaced, unemployed, and underemployed people in depressed areas of the country and should help to insure people against job-outcome uncertainty by making repayment terms contingent on the borrower’s postmove employment and income. This proposal extends government support for work-related moves that already are included in the U.S. tax code but that primarily benefit higherincome households. The author’s calculations suggest that the benefits compare favorably with the costs from alternative federal efforts. Perhaps more importantly, this proposal helps address a persistent market failure that limits the ability of low-income families to borrow against future earnings to “invest” in job-promoting residential moves.

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by making economic growth broad-based, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments. Our strategy—strikingly different from the theories driving economic policy in recent years—calls for fiscal discipline and for increased public investment in key growth-enhancing areas. The Project will put forward innovative policy ideas from leading economic thinkers throughout the United States—ideas based on experience and evidence, not ideology and doctrine—to introduce new, sometimes controversial, policy options into the national debate with the goal of improving our country's economic policy.

The Project is named after Alexander Hamilton, the nation's first treasury secretary, who laid the foundation for the modern American economy. Consistent with the guiding principles of the Project, Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces.

The Hamilton Project Update

A periodic newsletter from The Hamilton Project
is available for e-mail delivery.
Subscribe at www.hamiltonproject.org.

THE HAMILTON PROJECT

1775 Massachusetts Ave., NW
Washington, DC 20036

(202) 797-6279

BROOKINGS

Printed on recycled paper.