

Book Review

Unemployment Insurance in the United States: Analysis of Policy Issues,
O’Leary, Christopher and Wandner, Stephen A., eds. (W.E. Upjohn
Institute for Employer Research, 1997. 761 pp. \$55.56).

reviewed by Paul L. Burgess†

This collection of readings is essential for anyone interested in the Unemployment Insurance (“UI”) system in the United States. The interested set of readers should include policymakers, worker groups, firms, UI administrators, and researchers. The current volume represents the third in a trilogy of reference works on the U.S. system supported by the W.E. Upjohn Institute for Employment Research. Haber and Murray began the series in 1966 with *Unemployment Insurance in the American Economy*, which continues to be a valuable reference source even today. Next, Blaustein expanded and extended the scope of the first volume to include subsequent developments in the U.S. program, to place the first fifty years of the American program in historical context, and to examine the evolution of UI programs in the U.S. and abroad in his 1993 volume entitled *Unemployment Insurance in the United States: The First Half Century* (hereinafter *Unemployment Insurance Policy*). The current volume differs from its predecessors because, rather than describing the system and its historical evolution, O’Leary and Wandner have chosen contributors who emphasize what we have learned from hundreds of often complex studies of the U.S. system. In many cases, the chapters probably also provide useful insights into the incentives and outcomes likely to accompany similar UI features in other countries.

The organization of *Unemployment Insurance Policy* reflects the fact that the UI program is a federal-state partnership. The Social Security Act and the Federal Unemployment Tax Act provide the federal context within which each State operates its program according to state laws and policies. The result of this framework is a rich diversity in how states operate their individual programs. Benefit eligibility, duration, and amounts are

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determined by the states, within broad federal guidelines. Benefits are financed by payroll taxes that also are determined by each state, including the requirement that tax rates must vary with the unemployment experience of individual firms. The above thumbnail sketch of the UI system indicates the broad array of policy issues that are likely to develop in such a system. These issues cover a range of topics from federal-state relations to benefit eligibility, funding solvency for benefit payments, employment and unemployment effects, fraud within the system, and comparisons with systems in other countries. *Unemployment Insurance Policy* deals with each of these issues and others as well.

Unemployment Insurance Policy contains separate chapters on thirteen major policy issues, as well as an introduction that provides a context for the volume and a concluding chapter that highlights some key findings and trends from the earlier chapters. The conclusion also identifies some major trends and discusses ideas for reform. The thirteen major policy topics in *Unemployment Insurance Policy* indicate the breadth of this volume:

- UI coverage and reciprocity rates;
- Initial UI eligibility issues and requirements;
- Continuing UI eligibility issues, practices, and outcomes;
- Adequacy of the UI weekly benefit amount;
- Duration of UI benefits;
- Work incentives and disincentives of the UI system;
- Trends in UI funding and the relation of experience rating to employment fluctuations;
- UI reserves for financing benefit payments, state borrowing patterns, and flexible financing provisions;
- Fraud, abuse, and errors in the UI system;
- The role of the Employment Service in assisting the unemployed and developing the workforce;
- The intersection of the UI program with other income support programs and programs for dislocated workers;
- Federal-State relations, with special emphasis on administrative funding issues; and
- Comparisons of unemployment programs and systems in the Group of Seven Nations.

The above listing accurately conveys the extremely broad scope of this nearly 800 page volume. As with any compendium of summarized studies, the quality of the chapters varies. But I think a fair characterization of the volume is that every chapter contains useful information and provides valuable insights into the best thinking on each of the topics. Moreover, I believe that *Unemployment Insurance Policy* should be on the “must read” list of anyone interested in any topic included in this volume, whether the interest is for administrative, research, or policy purposes.

The scope of *Unemployment Insurance Policy* makes it impossible to cover each chapter in this brief review. Instead, I provide a few comments on selected chapters. The opening chapter by Blaustein, O'Leary, and Wandner provides nothing new in terms of research findings, but it does a wonderful job of providing an overview of the role of UI in the U.S. economy and the policy issues, incentives, and conflicts that arise because of the system's design. This chapter should be read by anyone who wants to get a quick read on the big issues confronting the UI system in today's economy.

One of the perplexing issues in recent years has been the large decline in UI reciprocity rates over the long term, and especially the marked drop in UI reciprocity rates in the early 1980s that has not since been reversed. The drop in UI reciprocity rates occurred, despite major extensions of UI coverage to new groups of workers since the early 1950s. The second chapter of the volume by Bass and McMurrer provides an excellent summary of prior research on this topic and also adds some new findings. The chapter effectively organizes the potential causes of this perplexing trend into various categories, such as federal and state policy changes, population shifts among states (with different reciprocity rates), the decline of manufacturing (which has a high reciprocity rate), and other demographic and economic factors. This chapter is an important addition to our understanding of factors that have contributed to markedly lower UI reciprocity rates over the past forty years.

The adequacy of the weekly benefit amount has long been an important issue in the UI program. The chapter by O'Leary and Rubin summarizes prior work on this topic and adds some interesting new observations on the subjective issue of what constitutes an adequate weekly benefit. As one who has contributed some of the prior research on expenditure based adequacy measures, I was pleasantly surprised by the contribution this chapter makes to our understanding of this issue. The authors concisely summarize a number of different approaches to this topic and effectively contribute some new insights on theoretically pinning down an adequate benefit. Because prior research shows that the level of the maximum weekly benefit is a key determinant of adequacy, they carefully examine how various state maximum formulas impact benefit adequacy. This chapter advances our knowledge and provides a perceptive study of the important policy issues involving the adequacy of UI benefits.

Woodbury and Rubin rise to a difficult challenge: usefully adding to the enormous literature on the duration of benefits. They far exceeded my expectations on what we might learn on this well-analyzed topic. The authors accomplish this by first providing a masterful summary of the huge diversity among the states in terms of "regular" and extended (in recessions) benefit duration provisions. They then use this background to

analyze “optimal” duration provisions, how duration limits feed into the question of UI exhaustion rates, and how UI exhaustees fare in the labor market. They provide an especially detailed analysis of extending benefits during recessions. Whether one agrees with their policy recommendations for extended benefits, their analysis should be examined for anyone considering this issue.

The UI financing system raises tax revenue from “experience-rated” payroll taxes that are levied on employers in all states (and supplemented by levies on workers in a few states). The use of tax rates that vary with employer experience with unemployment is unique to the U.S. system. Also unique to the U.S. system is a maze of administrative funding regulations that determine the level of federal funding that is returned to each state (from state payroll taxes) to fund state administrative operations. Many of the complex issues that arise from the convoluted federal-state taxing and administrative funding mechanism are addressed in two chapters in this volume, one by Levine and the other by Miller, Pavosevich, and Vroman. Together these chapters make a valuable contribution to our understanding of these largely arcane issues. The chapter by Miller, Pavosevich, and Vroman details the historical adequacy/inadequacy of trust fund reserves for paying benefits. Although current trust fund levels are more adequate than during the late 1970s and early 1980s, they show that reserves likely would be quickly exhausted—thereby triggering state borrowing from the federal government—in a recession of average post-World War II severity.

Levine shows that the burden of unemployment payroll taxes has steadily shifted from high-wage to low-wage workers (due to taxable wage base maximums that are low relative to the average wage). Levine’s other main point, which is well documented, will surprise many because experience rating generally has been accepted as a desirable feature that discourages “unnecessary” layoffs in downturns. However, because the UI tax is an adjustment cost, improved experience rating may result in fewer layoffs during downturns but at the cost of fewer new hires during expansions. Thus, stronger experience rating may not be part of an optimal system, in contrast to earlier research that had emphasized layoffs during downturns but not hiring in expansions. Overall, there is not enough evidence to make the judgment on the optimal degree of experience rating, but the Levine chapter nicely lays out the relevant issues and provides a necessary caution for those inclined to believe that stronger versus weaker experience rating necessarily is desirable.

Fraud and abuse is a high profile issue in any system that subsidizes one form of activity over another. In the case of the UI program, the subsidy is for nonemployment over employment, leading to inevitable questions of whether workers “deserve” benefits and whether they abuse

the system or commit fraud in obtaining those benefits. Skrable surveys the literature on these issues and also provides a solid framework for analyzing how and why errors and abuse can arise in the current system. He emphasizes that errors and abuse can arise among employers and state workers, as well as claimants, even though the popular focus almost always is on claimant abuse.

Based on my prior research and Skrable's summary of it and other work, I would emphasize the following points about UI system errors and abuse. First, "true" error rates and abuse levels always will be higher than the estimates from official monitoring systems: it would be irrational to spend enough to detect all or nearly all errors. Second, many errors arise because the current system is simply too complex to administer, especially given declining real funding for administrative operations. Unfortunately, policymakers, administrators, and stake holders often resist attempts at simplifying the arcane and impossible-to-accurately-enforce complexity currently found in the system. Third, states respond to incentives just as firms and workers do. A predictable effect of publishing the results of early benefit audits was that many states dropped work search requirements, simply because such requirements accounted for the single largest source of benefit overpayments. Some may view this change with alarm, but *very* few states use any effective means of monitoring work search efforts, even if they have the requirement. Fourth, the research by my colleagues and myself that is reviewed by Skrable clearly documents that both workers and employers respond to the costs and benefits of gaming or cheating the current system. As a result, computerized profiles can be used to more efficiently allocate resources for collecting taxes and paying benefits. More reliance on such statistical profiling, combined with major simplification of the existing system, would go a long way toward reducing abuse, errors, and fraud to "efficient" levels (again, cost makes it inefficient to detect or prevent every error).

Perhaps the above comments on a few of the Chapters included in *Unemployment Insurance Policy* will provide some support for my earlier claim that anyone interested in any of the topics in this excellent volume should place it on the "must read" list.