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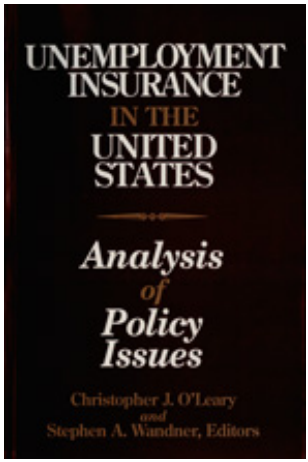

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CHAPTER 6

The Duration of Benefits

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Unemployment insurance (UI) benefits have two dimensions: the weekly benefit amount and the potential duration of benefits. How much is paid per week and for how long are the two questions uppermost in the mind of an eligible UI claimant.

This chapter is concerned with issues involved in establishing both "regular" benefit duration and the duration of "extended" benefits. By "regular benefits," we mean the benefits provided by states during nonrecessionary times. Regular state benefits are often referred to as the "first tier" of the UI system. By "extended benefits," we mean benefits that are paid in periods of high unemployment.

There have been two types of extended benefit programs in the United States. The first is the permanent standby Extended Benefit (EB) program enacted under the Federal-State Extended Unemployment Compensation Act of 1970. This program is supposed to activate automatically in a recession so as to provide extra weeks of unemployment benefits to workers who cannot find reemployment in hard times. The EB program is often referred to as the "second tier" of the UI system. The second type of extended benefit program is the federal "emergency" program. Congress has extended the duration of UI benefits on a temporary and discretionary basis during each of the last six recessions in the belief that the benefit durations provided by the first and second tier programs were insufficient. The various emergency programs are often referred to as the "third tier" of the UI system. The fol-

lowing two sections focus mainly on regular benefits, whereas the third section discusses the various extended benefit programs.

Three main questions arise in making policy on benefit duration. First, should benefits be offered to workers for a limited time or in perpetuity, and if they are offered for a limited time, what is the correct limit? Second, should all eligible workers face the same potential duration of benefits, or should potential duration vary with the work history and earnings of a worker? Third, should the duration of benefits be extended when labor markets are slack, and if so, what should be the relationship between labor market conditions and the potential duration of benefits?

We treat these questions from both institutional and analytical perspectives. In the first section, which follows, we review actual practice—how states set regular benefit durations—and briefly discuss some of the implications of that practice. We also discuss the waiting period and other interstate differences in potential duration. In the second section, we treat the adequacy and optimality of UI benefit duration, reviewing both the traditional institutional approach and modern analytical ways of examining duration adequacy. We discuss the historical and institutional reasons for existing practice in the states, empirical measures of duration adequacy such as the UI exhaustion rate and experience of UI exhaustees, the work disincentive effects of increasing the potential duration of benefits, and analytical work on optimal UI. Our goal is to provide a framework in which existing practice can be evaluated. In the third section, we address the matter of extending benefits during economic downturns. Along with issues of UI eligibility and coverage (treated by Bassi and McMurrer in chapter 2), benefit extensions have been the most visible source of contention and debate in UI during the last twenty-five years. Benefit extensions raise again many of the issues discussed in the next two sections, and provide a test of whether research on the duration of benefits has been fruitful. The final section provides a summary and some provisional conclusions.

How States Determine the Potential Duration of Benefits

From the beginning of the UI program in the United States, the generally accepted goal has been to provide a limited number of weeks of benefits, payable only long enough to tide an unemployed worker and household over a temporary spell of unemployment. Consensus on the meaning of "temporary" has changed over time—from 15 weeks, which was the most common potential duration at the beginning of the program in 1935, to 26 weeks, which is the maximum in all but two states today.

The apparent consensus in the United States that 26 weeks is a reasonable duration of benefits masks considerable variation among the states in how the duration of benefits is determined. Some states provide the same duration of benefits to all eligible claimants, whereas others vary benefit duration according to a claimant's past employment or wages. As a result, there are substantial differences among the states in the amount of prior work or wages required to qualify for different benefit durations. In the first part of this section, we review the various formulas used to compute benefit duration.

In addition, states differ in how long an unemployed individual must wait before receiving benefits. Originally, uncompensated waiting periods of two or more weeks were common. Currently, one week is required in most states and none in a few. Issues pertaining to the waiting period are reviewed in the second part of this section.

Finally, a few states provide benefits beyond the regular duration under special circumstances, for example, when workers are dislocated by a plant closing or by general permanent shrinkage of an industry. Also, two states have a regular maximum duration of 30 weeks, rather than the otherwise universal 26 weeks. These interstate variations are reviewed briefly in the last part of this section.

Potential Duration Formulas

Table 6.1 provides a summary of the practices used by the states to determine the potential duration of benefits. As can be seen in the first two columns, nine states currently provide the same potential duration of benefits to all who meet the minimum qualifying requirement (that is, the minimum and maximum potential durations are the same).

Table 6.1 Potential Duration of UI Benefits: Summary of State Practices, 1995

State	Potential duration (weeks)		Minimum requirement for maximum potential duration					State minimum weekly benefit amount
	Minimum	Maximum	Base-period earnings ($)	High-quarter earnings ($)	*a*	*b* (%)	*g*	
Alabama	15	26	1,716	516	0.33	4.17	7.91	22
Alaska	16	26	1,000	250-286	1.31	17.60	7.44	44
Arizona	12	26	3,120	1,000	0.33	4.00	8.25	40
Arkansas	9	26	3,588	897-1,183	0.33	3.85	8.57	46
California	14	26	2,080	900-920	0.50	4.35	11.49	40
Colorado	13	26	1,950	488-649	0.33	3.85	8.57	25
Connecticut	26	26	600	150	0.65	3.85	16.88	15
Delaware	23	26	2,184	966	0.50	4.35	11.49	21
District of Columbia	20	26	2,600	1.300	0.50	3.85	12.99	50
Florida	10	26	1,040	260	0.25	3.85	6.49	10
Georgia	9	26	3,848	962	0.25	4.00	6.25	37
Hawaii	26	26	130	32.5-105	1.00	4.76	21.00	5
Idaho	10	26	3,690	1,144	0.31	3.85	8.05	44
Illinois	26	26	1,600	400-1,160	0.83	3.77	22.02	51
Indiana	14	26	18,757	4,800	0.28	5.00	5.60	50
Iowa	11	26	2,496	740	0.33	4.34	7.60	32
Kansas	10	26	4,914	1,229-1,482	0.33	4.25	7.76	63
Kentucky	15	26	1,857	750	0.33	4.74	6.96	22

Louisiana	8	26	3,081	800	0.27	4.00	6.75	10
Main	21	26	2,730	683	0.33	4.55	7.25	35
Maryland	26	26	900	576	0.72	4.17	17.27	25
Massachusetts	10	30	2,000	500	0.36	3.85	9.35	14
Michigan	15	26	2,100	525-781	0.52	5.38	96.7	42
Minnesota	10	26	2,999	1,000	0.33	3.85	8.57	38
Mississippi	13	26	2,340	780	0.33	3.85	8.57	30
Missouri	11	26	3,510	1,000	0.33	4 50	7.33	45
Montana	8	26	4,469	1,117-1,375	0.32	4.00	8.00	55
Nebraska	20	26	1,575	394-400	0.33	5.00	6.60	20
Nevada	12	26	1,248	400	0.33	4.00	8.25	16
New Hampshire	26	26	2,800	1,200	0.30	4.40	6.82	32
New Jersey	15	26	4,375	1,094-1,623	0.45	4.62	9.74	75
New Mexico	19	26	1,777	1,068	0.60	3.85	15.58	41
New York	26	26	1,600	400	0.65	3.85	16.88	40
North Carolina	13	26	2,603	651-868	0.33	3.85	8.57	25
North Dakota	12	26	3,572	1,118	0.32	3.85	8.31	43
Ohio	20	26	6,864	1,716	0.25	3.85	6.49	66
Oklahoma	20	26	1,000	2,600	0.40	4.00	10.00	16
Oregon	4	26	5,304	1,326-1,360	0.33	5.00	6.60	68
Pennsylvania	16	26	1,357	900	0.69	4.00	17.25	35
Puerto Rico	26	26	280	75	0.58	9.30	6.24	7
Rhode Island	15	26	2,961	890	0.36	4.62	7.79	41

(continued)

Table 6.1 (continued)

State	Potential duration (weeks)		Minimum requirement for maximum potential duration					State minimum weekly benefit amount
	Minimum	Maximum	Base period earnings ($)	High-quarter earnings ($)	*a*	*b* (%)	*g*	
South Carolina	15	26	1,560	540	0.33	3.85	8.57	20
South Dakota	15	26	2,183	728	0.33	3.85	8.57	28
Tennessee	12	26	3,120	780	0.25	3.85	6.49	30
Texas	9	26	4,044	1,011-1,050	0.27	4.00	6.75	42
Utah	10	26	1,800	450-486	0.27	3.85	7.01	17
Vermont	26	26	1,628	1,163	0.42	4.44	9.46	25
Virginia	12	26	6,760	1,625	0.25	4.00	6.25	65
Virgin Islands	13	26	2,574	858	0.33	3.85	8.57	33
Washington	16	30	5,694	1,825	0.33	4.00	8.25	73
West Virginia	26	26	2,200	550-600	0.28	4.00	7.00	24
Wisconsin	12	26	3,250	1,250	0.40	4.00	10.00	50
Wyoming	12	26	3,467	1,000	0.30	4.00	7.50	16

NOTES Parameter *a* is the maximum proportion of base-period earnings that can be paid in UI benefits during a given benefit year (see equation 3 in the text).

Parameter b is the proportion of high-quarter earnings paid as the weekly benefit amount (see equation 4 in the text)

Parameter $g = a/b$ and is an index of the state's potential duration generosity

These are usually referred to as uniform duration states. The number of states providing uniform duration has fallen over the years, as Blaustein (1993, table 10.7, p. 304) has discussed.

The other forty-four states vary potential duration according to each claimant's past employment or earnings. These states use one of two methods to compute potential duration. In six states—Florida, Michigan, New Jersey, Ohio, Oklahoma, and Pennsylvania—potential duration is an increasing function of the number of "credit weeks" worked in the base period (roughly, the year preceding the spell of unemployment), up to the maximum 26 weeks. A credit week is a week in which earnings equal or exceed some specified minimum, so that,

$$(1)\ D_{POT} = \min\ [f(\textit{credit weeks}), 26]$$

where D_{POT} denotes the potential duration of UI benefits and f is a function increasing in credit weeks. For example, in Ohio, a credit week is a week in which a worker earned at least 27.5 percent of the average weekly wage in the state. A worker qualifies for the minimum potential duration of 20 weeks of benefits by having 20 credit weeks in the base period. Then, the worker's potential benefit duration increases by 1 week for each additional credit week, up to the maximum of 26 weeks.

In thirty-eight states, the potential duration of benefits depends on the ratio of a claimant's base-period earnings to high-quarter earnings, up to the maximum 26 weeks. If we let *BPE* denote base-period earnings and *HQE* denote high-quarter earnings, then,

$$(2)\ D_{POT} = \min\ [f(BPE/HQE), 26]$$

where f denotes a function increasing in *BPE/HQE*. Note that *BPE/HQE* ranges from 1 for a worker whose entire base-period earnings were earned in a single quarter (*BPE* = *HQE* for such a worker) to 4 for a worker who had identical earnings in all four quarters (*BPE* = 4[*HQE*]). The idea is that a worker with stable earnings throughout the base period will have a higher *BPE/HQE* and hence a higher potential duration of UI benefits.

In five states, the relationship between *BPE/HQE* and potential duration is explicit. For example, in North Carolina, potential duration is simply 8.67 times *BPE/HQE* (up to 26 weeks), so that a UI-eligible worker with *BPE/HQE* of 3 or greater is eligible for the maximum potential duration of 26 weeks of benefits.

In 33 states, however, the relationship between *BPE/HQE* and potential duration is masked by the formula used to calculate potential duration. In these states, potential duration is calculated as some fraction, *a*, of base-period earnings divided by the weekly benefit amount (*WBA*), up to the maximum:

$$(3)\ D_{POT} = \min\ [a(BPE)/WBA;\ 26].$$

The parameter *a* limits the total UI benefits paid to a worker in the benefit year to some fraction of base-period earnings. In 18 states, $a = 1/3$, and, in the other 15 states, *a* ranges between .25 and .6. What needs to be noted is that in all of these states the weekly benefit amount is computed, in turn, as a fraction, *b*, of high-quarter earnings (or, in some cases, average earnings in the two highest quarters of the base period) up to some maximum:

$$(4)\ WBA = \min\ [b(HQE),\ WBA_{MAX}].$$

Typically, *b* is 1/25 (.04), so that the weekly benefit amount equals one-half of average weekly earnings in the high quarter. (The parameter *b* ranges from 1/26 [.038] to 1/20 [.05] in these 33 states.) Substituting the *WBA* formula (4) into the potential duration function (3) yields

$$(5a)\ D_{POT} = a(BPE)/b(HQE), \quad \text{if } WBA < WBA_{MAX}$$

or

$$(5b)\ D_{POT} = a(BPE)/WBA_{MAX}, \quad \text{if } WBA = WBA_{MAX}.$$

It follows that for eligible claimants whose *WBA* is less than the state's maximum,

$$(6)\ D_{POT} = g(BPE/HQE)$$

where

$$(7)\quad g = a/b,$$

so the dependence of potential duration on *BPE/HQE* is clear for claimants whose *WBA* is below the maximum. For claimants whose *WBA* is at the maximum, potential duration will still depend on the relationship between base-period and high-quarter earnings. For example, a worker who obtains the maximum *WBA* as a result of high earnings in just one quarter may have potential duration below the maximum 26 (or 30) weeks, since that worker's base-period earnings will be low relative to his or her weekly benefit amount.

The parameter g can be usefully interpreted as an index of a state's duration generosity. Specifically, it gives the increase in the number of weeks of potential duration that result from a unit increase in *BPE/HQE*. In table 6.1, we have computed g for all 53 "states" (that is, UI jurisdictions). (For states that do not explicitly use the parameters a or b in computing the potential duration of benefits, we have calculated an implied g numerically.) Also in table 6.1, we have calculated the minimum base-period earnings and high-quarter earnings that an eligible claimant would need in order to receive the state's maximum potential duration of benefits.

An examination of g and of the minimum earnings required for maximum potential duration in table 6.1 shows that the variations in states' duration provisions are significant. Claimants with similar base-period work experience qualify for quite different potential durations depending on the state in which they reside, and the requirements for 26 weeks of regular benefits vary dramatically among the states. For example, to qualify for 26 weeks of regular benefits requires as little as \$130 in the base period (with \$32.50 to \$105 in the high quarter) in Hawaii to as much as \$18,757 in the base period (with \$4,800 in the high quarter) in Indiana.

Variable duration reflects the notion that individuals "earn" their right to benefits by working, and that each week of benefits is earned by a given number of weeks of employment or earnings. The widespread use of variable duration also reflects two further concerns: first, that uniform duration is more expensive than variable duration, and second, that uniform duration can generate a high ratio of total benefits

paid to base-period earnings, which could in turn lead to strong work disincentives.[1] We return to these issues in the discussion of extended benefits and again in the conclusion.

The Waiting Period

The waiting period has been debated since the beginning of the UI system in the United States. In all but a dozen states, a claimant must serve an uncompensated one-week period of unemployment before receiving benefits. At the beginning of the program, 31 of the state laws required a waiting period of two weeks, 17 required three weeks, and three required four weeks (Haber and Murray 1966, p. 200).

The waiting period was included in the early laws for reasons of both administration and financing. It allowed time for processing claims manually and for making determinations and contesting them before the end of the first compensable week. It also helped to conserve funds by avoiding compensation for short periods of unemployment. Over the years, however, experience showed that the waiting period was unnecessary for effective administration. Also, although a waiting period clearly increases fund solvency (other things being equal), the fact that several states have eliminated the waiting period shows that it is not essential for fund solvency.

Accordingly, some have argued that the waiting period should be eliminated entirely. The main argument for dropping the requirement is that it causes a delay in providing claimants with income in the early stages of their spell of insured unemployment. Since payment of a claimant's first benefit check usually occurs no earlier than three full weeks following the filing of the first claim, the existence of a waiting week means that the first check will represent compensation for only one week of unemployment. Eliminating the waiting week would not shorten the time it takes to deliver the first check, but that check would cover two weeks of unemployment instead of just one. This would be helpful if, as is often the case, a worker has delayed filing a claim until after being unemployed for some time.

Eliminating the waiting week requirement would be a relatively expensive step, however. In addition, an accumulating body of research and evidence suggests that it would be good public policy to extend the waiting period and to use the savings to finance a longer potential dura-

tion of benefits. O'Leary's (forthcoming) findings, which are discussed below, suggest that short spells of unemployment are overcompensated by UI, whereas long spells are under-compensated. Jacobson, LaLonde, and Sullivan (1993a, 1993b, 1993c) show clearly that dislocated workers suffer large losses of firm- and occupation-specific human capital that no existing program—including UI—even begins to address. This research provides a rationale for extending the waiting period and providing a longer potential duration of benefits.[2]

The number of states that impose a waiting week has been influenced strongly by a 1980 federal amendment to the federal-state Extended Benefits (EB) law. That amendment was one of several intended to reduce UI program costs by providing incentives for states to reduce the generosity of their regular UI benefit provisions.[3] It eliminated the federal 50 percent matching share for the first week of EB in any state that has no waiting week for regular benefits. The amendment also applies to states that have a waiting week for which the individual is later reimbursed if still unemployed after a specified period, and to states that waive a waiting week requirement if it would interrupt a continuous spell of insured unemployment.

The prospect of losing the federal share of funding for the first week of EB motivated some states to restore a waiting week and deterred others from eliminating it. Before the federal change in 1980, there had been a trend toward removing the waiting week, which peaked at twelve states with no waiting week and nine states that paid it after a specified number of weeks of unemployment. By 1984, the number was down to nine and six states, respectively. However, mainly because the EB program has become ineffective in recent years, the number of states without waiting week provisions has risen to twelve, although the number of states paying for the waiting week retroactively is now down to four.

A few states provide two exceptions to the waiting week requirement. The first exception applies when a claimant is unemployed and receiving benefits at the end of a benefit year. If the period of unemployment extends into the new benefit year, the individual may serve a waiting period for the new year either at the beginning or later in that new benefit year. The second exception allows claimants to serve a waiting period the week before beginning a new benefit year. This provision is advantageous to claimants who are unemployed for some time

before they are able to begin a new benefit year; examples include claimants who exhaust benefits before the expiration of the first benefit year and remain unemployed or claimants who incur a second spell of unemployment before expiration of the first benefit year.[4]

As mentioned, a few states convert the waiting week into a compensable week after a specified period of unemployment. Since most unemployment is short-term, these states frequently never pay for the first week. However, such provisions could create an incentive to remain unemployed long enough to be paid for that week. No state currently provides for payment of the waiting week to individuals who find suitable, stable employment within a minimum period, although such a provision could create an incentive for quick reemployment, along the lines of a reemployment bonus.

Other Interstate Variations

Increased Duration under Special Conditions

A few states extend regular benefit duration for workers whose unemployment resulted from structural change such as shifts in demand or changing technology. Structural change usually manifests itself in plant closings or in the permanent shrinkage of an entire industry. Hence, these programs can be thought of as state-level dislocated worker extensions.[5]

A Hawaii law separate from the regular UI law provides an additional 13 weeks of benefits to individuals unemployed when a natural or other disaster causes damage that results in widespread unemployment. Puerto Rico provides up to 32 weeks of extended benefits to individuals who are dislocated as a result of technological change, closure of a plant or industry, or the elimination or reduction of sugar cane crops.[6]

In Iowa, potential benefit duration is normally computed as 1/3 of base-period earnings divided by the weekly benefit amount, up to a maximum of 26 weeks. However, for workers laid off because their employer went out of business, duration is computed as 1/2 of base-period earnings divided by the weekly benefit amount, up to a maximum of 39 weeks. In other words, the parameter a in table 6.1 increases from 1/3 to 1/2 for dislocated workers. Minnesota provides up to 6 weeks of extended benefits to workers affected by a mass layoff—defined as a permanent work force reduction of at least 50 percent

in a facility employing 100 or more workers—when the county unemployment rate is at least 10 percent.

Other states also extend regular duration to dislocated workers but on a different basis. Massachusetts and Michigan have long provided additional weeks of benefits to claimants attending vocational retraining courses approved by the employment security agency. In both states, benefits may be extended up to 18 weeks.

State-level extensions such as these reflect a view that, at least for dislocated workers, regular benefits of 26 weeks are inadequate either to compensate a worker for permanent job loss and for the loss of firm- and occupation-specific human capital it implies, or to support a worker through a period of retraining that may be needed after permanent job loss. Of course, the enactment of such state-level extensions requires both a political consensus and favorable fiscal conditions, and the existing state-level extensions fall short of the comprehensive commitment to retraining advocated by some.

Maximum Duration

In 1979, twelve states paid more than 26 weeks of regular benefits. This represented the peak of a trend toward higher maximum durations that characterized the UI system in the United States into the 1970s. The trend was reversed in the 1980s, and, by 1989 (and still today), only two states (Massachusetts and Washington) provided regular benefit duration maximums in excess of 26 weeks. As can be seen in table 6.1, all other states have a maximum potential duration of regular benefits of 26 weeks.

Particularly in the 1960s and 1970s, there were several federal and other proposals to induce states to extend regular benefit duration beyond 26 weeks. In 1963 and 1965, for example, the Kennedy and Johnson administrations proposed a program of Federal Unemployment Adjustment Benefits (FUAB), payable in both good and bad times to those with long and substantial employment experience (Murray 1974, pp. 30-32). Thirteen weeks of FUAB would have been made available to individuals unemployed more than 26 weeks, provided they had at least 26 weeks of work in the base period and 78 weeks of work in the base period and the preceding two years. In that it would have provided extended benefits to workers with strong employment histories, the FUAB proposal resembled the types of dislocated worker

programs that have been discussed recently (see, for example, Jacobson, LaLonde, and Sullivan 1993a, chapter 7), but no action was taken by Congress on the proposal.

In 1972, a committee of the Interstate Conference of Employment Security Agencies (ICESA) recommended to ICESA's Executive Committee that the federal government give a 50 percent subsidy for any week of regular benefits beyond the 26th week (up to 39) that any state saw fit to provide, under whatever conditions the state considered necessary (Murray 1974, pp. 25-26). ICESA took no action on the recommendation.

In 1973, it was reported that the Nixon administration was considering a proposal to require all states to set a maximum duration of at least 39 weeks (Murray 1974, pp. 26, 59). States would be reimbursed for 50 percent of the cost of benefits in excess of 26 weeks. Proportionately more work experience in the base period would be required for a claimant to qualify for benefits beyond 26 weeks: for example, 39 weeks would require 50 percent more than was required for 26 weeks. However, no proposal was actually introduced to Congress.

Thus, various proposals to extend regular benefit duration have been put forward and rejected over the years. It seems highly unlikely that proposals to increase regular state benefit durations would fare well today. An approach that provided federal financing without federal control would be more in keeping with the philosophy of the Republican Congress than an approach that dictated federal standards, but the budgetary implications of any such subsidy make it extremely unlikely.

The reluctance of states to extend benefits beyond 26 weeks has stemmed from at least three sources: first, the strains on state funds during the high unemployment of the mid-1970s and early 1980s; second, the federal conditions adopted in the 1980s for state repayment of federal advances; and third, enactment in 1970 of the federal-state EB program.

Adoption of EB in 1970 is arguably the major reason for the decline in the number of states with regular benefit durations in excess of 26 weeks. In brief, the EB program extends benefits in states where labor market conditions have deteriorated during the preceding one to two years. (We discuss EB in greater detail in the third section of this chapter.) EB extends potential duration by one-half of a claimant's regular benefit duration, up to a maximum of 13 weeks. Hence, when EB is in

effect in a state, claimants gain no advantage from the availability of regular benefits beyond 26 weeks: the maximum weeks of combined regular benefits and EB is 39. In other words, when EB is in effect, claimants are eligible for the same 39-week potential duration whether the duration of regular state benefits in their state is 26 weeks or 30 weeks (or any other potential duration of regular benefits between 26 and 39 weeks). Moreover, EB is funded half from state UI trust funds and half from federal UI trust funds. Accordingly, EB results in a smaller drain on state UI trust funds than do benefits in excess of 26 weeks provided by a regular state program.

For the same reasons, adoption of EB is clearly the main reason for the decline in the number of states with their own extended benefit programs. In the mid-1970s, ten states had such programs, activated on the basis of particular state unemployment rates. By 1989, only three states (Alaska, California, and Connecticut) had such programs.

In sum, adoption of EB seems to have produced the acceptance of two ideas. The first is that unemployment beyond 26 weeks ceases to be solely a state responsibility. The second is that UI benefits should extend beyond 26 weeks only during periods of high unemployment.

Duration Adequacy and Optimality

The most obvious question in unemployment benefit duration is also the most difficult: What should be the potential duration of benefits? It is useful to think of the approaches to this question as either institutionalist or analytical, although the line between the two is not hard and fast. The institutionalist approach relies on historical observation, pragmatic considerations, and informal examination of data to gain an impression of whether benefit durations are adequate. The analytical approach makes explicit use of economic reasoning and modeling. In the first two parts of this section, we discuss the institutionalist approaches to benefit duration, describing the historical rationale for the existence of limited potential duration, and reviewing the literature on UI exhaustion rates and the experience of exhaustees. In the last two parts, we look at existing analytical work on the disincentive effects of increases in potential duration on the optimal duration of benefits.

We view the alternative approaches to duration adequacy as complementary rather than as competing ways of gaining insight into whether benefit durations are adequate. As will be seen, neither approach has progressed to the point where unequivocal or wholly convincing answers are supplied.

Historical Rationale for Limiting Potential Duration

Originally, financial concerns were the primary reason for limiting the duration of benefits. When the program began in 1935, actuaries argued that a 3 percent payroll tax could finance only 12 to 15 weeks of benefits. The actuaries' estimates were based on the unemployment experience of the 1930s, and, of course, such high rates of unemployment have not recurred. Indeed, actual payroll tax rates are now well below those originally contemplated (on average), yet the maximum benefit durations provided are now well above those originally contemplated.

In 1942, the Social Security Board acknowledged the importance of funding considerations in limiting benefit duration but also urged states to provide more weeks of benefits "unless fund conditions forbid."[7] In 1950, the U.S. Department of Labor reaffirmed the concept of limited potential duration, but for reasons that went beyond cost considerations. It concluded that potential duration should be limited mainly because UI is "short-term" insurance, intended to provide protection only to workers who are currently attached to the labor force and who are unemployed between jobs. UI is not intended for long-term unemployed workers for whom job search assistance, retraining, or relocation would be more appropriate.

Having reaffirmed the commitment to limited potential duration, the Department defined the limits of potential duration with respect to program goals:

> Whether the unemployment insurance program achieves its major objective of covering the nondeferrable expenses of insured workers during periods of involuntary unemployment without diminishing their savings appreciably or compelling them to draw on other community resources depends on the duration of payments as well as the amount of the weekly payments. To accomplish this purpose, the duration of benefits should be sufficient to enable the

> great majority of insured workers to find suitable work before exhausting their benefit rights, under normal or recession conditions. In statistical terms, *the benefit period should be long enough to ensure that no more than 25 percent of the beneficiaries exhaust benefits under recession or better conditions* [emphasis added] (*Manual of State Employment Security Legislation* 1950, p. C-33).

By 1962, the Department of Labor's concept of limiting potential duration had translated into recommendations to the states: first, "that all eligible claimants be allowed a uniform potential duration of at least 26 weeks of benefits," and second, "that, if a State considers that it must vary duration in relation to base-period employment or wages, the variable potential duration should range from a minimum of 20 weeks to a maximum of at least 30 weeks" (*Unemployment Insurance Legislative Policy* 1962, p. 37). Thus, although federal adherence to the concept of limited duration remained constant over the years, the limit changed from 15 weeks in 1935 to double that in 1962. It is telling, perhaps, that there has been no comparable policy statement in the last 35 years.

Although duration maximums have increased over the years, there remains wide acceptance of the idea that the potential duration of benefits should be limited. This view seems to stem in part from the belief that under reasonably good economic conditions workers should be able to find reemployment reasonably quickly, and in part from concerns about moral hazard—that workers offered benefits of unlimited duration would extend their spells of unemployment to unacceptable lengths. Finite benefit extensions have been considered acceptable when labor markets are slack, but UI has been eschewed as a standing policy to assist long-term unemployed workers.

Two arguments have been made against extended benefits for long-term unemployed workers: first, such payments involve a drain on the trust fund, and second, they undermine the insurance character of the program (see Hansen and Byers 1990 for a cogent statement of the latter argument). The second of these arguments is important enough to deserve a brief restatement. When the UI system came into being in the United States, political considerations connected with financing the program dictated that it could cope only with brief spells of unemployment. Large industrial employers were induced to support UI legislation, with financing through an experience-rated payroll tax, by the

promise that their workers on temporary layoff would receive benefits and hence would be available for recall when demand improved. It followed that the program could insure only against short-term unemployment. Dislocated workers and other long-term unemployed were not the object of the UI system, so to finance programs for such workers—such as retraining and income support during retraining—out of the UI trust fund would undermine the finances of the program.

The irony is that the main problems of the Great Depression were permanent job loss and long-term demand-deficient unemployment, not short-term or temporary layoff unemployment. So it really cannot be argued that UI, by insuring mainly against short-term spells of unemployment, met the needs of the 1930s, except that it was better than no system at all. There is also an element of ad hominem argument here: once we define UI as a program that is intended to insure workers against short spells of unemployment, then, by definition, providing benefits for longer spells of unemployment undermines the "integrity" and insurance character of the program. *Unemployment insurance was defined as a program for short-term unemployment out of financial and political expediency, not after consideration of whether permanent job loss or long-term unemployment are insurable risks that demand some form of social insurance.* Arguments that UI is a program for short-term unemployment—and that it should keep doing what it already does—do tell us what the program is, but they beg the question of what the program ought to be.

Much criticism of the UI system during the early 1990s amounted to a criticism of the failure of UI to assist dislocated and long-term unemployed workers. Indeed, the main change in the UI system that the Clinton administration has initiated—UI "profiling"—is intended to address this criticism and to assist workers who are likely to experience long spells of unemployment. The purpose of profiling (which is discussed further in the next section) is to speed reemployment of dislocated workers given that the political climate is so unfavorable to offering extended benefits to such workers.

However, traditional defenders of the system believe that the recent criticism of UI is based on a misunderstanding of its purpose; that is, they argue that the system is intended only to alleviate the hardship of short-term unemployment, particularly due to temporary layoffs. Again, it is clear that the system would have been politically infeasible

in the 1930s had it provided more generous or long-term benefits and that the system has evolved so as to deal best with short-term unemployment. As the work discussed in the last part of this section suggests, on the other hand, it is unclear whether relatively generous compensation of short-term unemployment, and virtual neglect of long-term unemployment, is socially optimal. In other words, the goals of the system have been defined largely by looking at what the system has done and done well, rather than by examining what type of social insurance system (financed by a payroll tax) would improve the well-being of risk averse workers. The aims, it seems, have been set by circular reasoning—this is what the system does well; therefore, this must be its goal—rather than by thinking through the problem of insuring against the risk of job loss.

Exhaustion Rates and the Experience of Exhaustees

Past research has addressed whether the potential duration of UI benefits is adequate mainly by examining UI exhaustion rates—that is, the proportion of UI claimants who use up their entire regular state benefit entitlement[8]—and the experience of UI exhaustees. This has proven a useful approach, in that it has exposed the characteristics of state UI systems that tend to yield high or low exhaustion rates. However, in part because it lacks a normative framework, it has not led to a consensus about the proper duration of benefits.

Unemployment Insurance Exhaustion Rates

Ready availability of data to calculate the UI exhaustion rate has made it the most commonly used gauge of duration adequacy. In 1962, the U.S. Department of Labor last expressed the objectives of regular benefit duration:

> The program is intended to provide benefits for a sufficiently long period that, under reasonably normal business conditions and during short periods of recession, a high proportion of claimants can continue to receive benefits until they are called back to work or find other work (*Unemployment Insurance Legislative Policy* 1962, p. 35).

Although a "high proportion of claimants" has generally been considered as 75 percent (see the quote in the previous section from the *Man-*

ual of State Employment Security Legislation), it has never been defined carefully. Moreover, the terms "reasonably normal" and "short periods of recession" are quite vague. For example, "reasonably normal" meant higher rates of unemployment between the mid-1970s and late-1980s, when it was widely agreed that the natural rate of unemployment (that is, the rate of unemployment that is consistent with a constant rate of inflation) was higher than in earlier decades. In recommending an increase in the unemployment rates that activate the EB program, the Department of Labor argued in 1981 that "Structural changes in the labor force have contributed to a generally higher level of normal unemployment" (Rubin 1983, p. 125).

Table 6.2 displays the annual UI exhaustion rate (for the regular state program) from 1940 through 1994, along with the number of claimants who exhausted their regular UI benefits. The table also shows the total unemployment rate (for 1940 through 1994) and the average duration of unemployment in the economy (for 1948 through 1994).

Note that the regular exhaustion rate shown in table 6.2 is distinct from the total exhaustion rate, which is the proportion of UI claimants who use up both their regular state benefit entitlement and any extended benefits for which they qualify. The total exhaustion rate can never exceed the regular exhaustion rate and will be less than the regular exhaustion rate when an extended benefit program is in effect.

Not surprisingly, both the regular exhaustion rate and the number of exhaustees rise when aggregate economic conditions deteriorate—as reflected by increases in the unemployment rate and in unemployment duration. The main purpose of the extended benefit programs discussed in the following section has been to provide additional assistance to workers who exhaust their benefits under the regular UI program. Indeed, one of the main proposed goals of extended benefit programs has been to bring the *total* exhaustion rate (that is, the proportion of workers exhausting both regular and extended benefits) down roughly to the level of the regular exhaustion rate during nonrecessionary times (Hight 1975; Corson and Nicholson 1982). For example, Corson and Nicholson have estimated that the emergency extended benefit program that was implemented during the mid-1970s (Federal Supplemental Compensation) reduced the total exhaustion rate during the

Table 6.2 Regular UI Exhaustion Rate, Number of Regular UI Exhaustees, Total Unemployment Rate, and Unemployment Duration, United States 1940-1994

Year	Exhaustion rate (%) (1)	Number of regular UI exhaustees (000s) (2)	Total unemployment rate (%) (3)	Average duration of unemployment (weeks) (4)
1940	50.6	2,590	14.5	--
1941	45.6	1,544	9.7	--
1942	34.9	1,078	4.4	--
1943	25.5	194	1.7	--
1944	20.2	102	1.0	--
1945	18.1	250	1.6	--
1946	38.7	1,986	3.7	--
1947	30.7	1,272	3.5	--
1948	27.5	1,028	3.3	8.6
1949	29.1	1,935	5.3	10.0
1950	30.5	1,853	5.2	12.1
1951	20.4	811	3.2	9.7
1952	20.3	931	2.9	8.4
1953	20.8	764	2.8	8.0
1954	26.8	1,769	5.4	11.8
1955	26.1	1,272	4.3	13.0
1956	21.5	981	4.0	11.3
1957	22.7	1,139	4.2	10.5
1958	31.0	2,507	6.6	13.9
1959	29.6	1,676	5.3	14.4
1960	26.1	1,604	5.4	12.8
1961	30.4	2,366	6.5	15.6
1962	27.4	1,638	5.4	14.7
1963	25.3	1,872	5.5	14.0
1964	23.8	1,371	5.0	13.3
1965	21.5	1,087	4.4	11.8
1966	18.0	781	3.7	10.4
1967	19.3	867	3.7	8.7
1968	19.6	848	3.5	8.4

(continued)

Table 6.2 (continued)

Year	Exhaustion rate (%) (1)	Number of regular UI exhaustees (000s) (2)	Total unemployment rate (%) (3)	Average duration of unemployment (weeks) (4)
1969	19.8	811	3.4	7.8
1970	24.4	1,303	4.8	8.6
1971	30.5	2,057	5.8	11.3
1972	30.0	1,822	5.5	12.0
1973	27.7	1,508	4.8	10.0
1974	31.0	1,939	5.5	9.8
1974	37.8	4,195	8.3	14.2
1976	37.8	3,270	7.6	15.8
1977	32.5	2,850	6.9	14.3
1978	26.7	2,031	6.0	11.9
1979	26.7	2,037	5.8	10.8
1980	33.2	3,072	7.0	11.9
1981	32.4	2,989	7.5	13.7
1982	38.5	4,175	9.5	15.3
1983	38.4	4,180	9.5	20.0
1984	34.2	2,619	7.4	18.2
1985	31.2	2,575	7.1	15.6
1986	32.2	2,703	6.9	15.0
1987	30.6	2,409	6.1	14.5
1988	28.5	1,979	5.4	13.5
1989	28.0	1,940	5 3	11.9
1990	29.4	2,323	5.5	12.1
1991	34.8	3,472	6.7	13.8
1992	39.9	3,821	7.4	17.9
1993	39.2	3,204	6.8	18.1
1994	36.3	2,977	6 1	18.4

SOURCE· Columns 1 and 2 from *Unemployment Insurance Financial Data*, ET Handbook 394; columns 3 and 4 from *Handbook of Labor Statistics*, U S Department of Labor, Bureau of Labor Statistics, August 1989, and *Monthly Labor Review*, various issues.

1973-1975 recession to somewhat below the regular exhaustion rate during nonrecessionary times (Corson and Nicholson 1982, pp. 72-76).

In addition to cyclical ups and downs, however, there has been a secular rise in the regular exhaustion rate. For example, in 1994, which was not a recession year, 36.3 percent of UI claimants exhausted their regular benefits. This was only slightly below the exhaustion rates at the peak of the mid-1970s recession (37.8 percent) and of the early 1980s recession (38.5 percent). The regular exhaustion rate during the recession of the early-1990s, 39.9 percent, was a post-World War II high.

The secular increase in the regular exhaustion rate can be attributed partly to reductions over time in the generosity of state duration provisions and partly to the secular rise in unemployment spell durations. Although we do not explore these changes in detail here, some insight into the link between the generosity of state duration provisions and the exhaustion rate can be obtained from table 6.3, which displays the average potential duration of benefits (a proxy for duration generosity, in column 2) and the exhaustion rate (column 3) for each state in 1992. The most obvious point to note is that the nine states with uniform duration provide higher average potential duration than do any of the variable duration states.

The relationship between the generosity of state benefit formulas and the UI exhaustion rate can be seen more clearly in table 6.4, where we show the results of regressing the regular UI exhaustion rate on two variables: the average potential duration (which serves as a proxy for state duration generosity) and the total unemployment rate (as a proxy for labor market conditions). The data used in the regressions in table 6.4 come from table 6.3. A literal interpretation of the results is that states with greater average potential duration of benefits have lower exhaustion rates, so that a one-week increase in the average potential duration is linked to a 1.8 percentage point drop in the regular exhaustion rate. Also, states with higher total unemployment rates have higher regular exhaustion rates, so that a 1 percentage point rise in the unemployment rate is linked to a 3 percentage point rise in the regular exhaustion rate.

Table 6.3 (column 4) also shows the percentage of exhaustees eligible for fewer than 26 weeks of benefits. This is an alternative measure of duration adequacy, which Murray (1974) explored in some detail.

Table 6.3 Unemployment Rate, Average Potential Duration of UI, Exhaustion Rate, and Percentage of Exhaustees Drawing Fewer Than 26 Weeks of Benefits, by State, 1992

State	Total unemployment rate (%) (1)	Average potential duration of UI (weeks) (2)	UI exhaustion rate (%) (3)	Percentage of exhaustees drawing fewer than 26 weeks (4)
Alabama	7.3	24.1	24.7	45.6
Alaska	9.1	20.8	50.4	86.3
Arizona	7.4	23.0	39.9	51.4
Arkansas	7.2	22.8	35.7	56.8
California	9.1	24.2	44.2	26.2
Colorado	5.9	22.3	44.5	73.6
Connecticut	7.5	26.0	38.1	0.0
Delaware	5.3	25.6	27.1	10.9
District of Columbia	8.4	23.3	64.4	22.8
Florida	8.2	21.0	54.0	63.8
Georgia	6.9	21.5	39.8	74.3
Hawaii	4.5	26.0	34.5	0.0
Idaho	6.5	19.5	34.0	82.6
Illinois	7.5	26.0	42.0	0.0
Indiana	6.5	22.7	31.3	63.9
Iowa	4.6	22.4	30.0	64.2
Kansas	4.2	22.7	37.2	54 0
Kentucky	6.9	26.0	22.6	0.1

Louisiana	8.1	26.0	34.0	0.1
Maine	7.1	19.4	39.3	66.4
Maryland	6.6	26.0	21.1	0.0
Massachusetts	8.5	27.5	46.0	29.0
Michigan	8.8	22.7	35.0	54.0
Minnesota	5.1	23.4	33.3	51.3
Mississippi	8.1	23.4	33.3	50.8
Missouri	5.7	22.0	38.6	61.8
Montana	6.7	20.5	38.2	80.6
Nebraska	3.0	23.0	30.4	76.9
Nevada	6.6	22.7	39.7	50.6
New Hampshire	7.5	26.0	15.8	0.0
New Jersey	8.4	23.8	55.7	35.3
New Mexico	6.8	25.8	38.3	13.1
New York	8.5	26.0	51.5	0.0
North Carolina	5.9	23.0	21.1	61.8
North Dakota	4.9	19.9	38.5	78.4
Ohio	7.2	25.6	33.2	17.3
Oklahoma	5.7	21.6	43.6	78.0
Oregon	7.5	25.7	34.5	11.2
Pennsylvania	7.5	25.9	35.6	1.8
Puerto Rico	--	26.0	58.9	0.0
Rhode Island	8.9	21.7	44.8	59.0

(continued)

Table 6.3 (continued)

State	Total unemployment rate (%) (1)	Average potential duration of UI (weeks) (2)	UI exhaustion rate (%) (3)	Percentage of exhaustees drawing fewer than 26 weeks (4)
South Carolina	6.2	23.1	30.5	50.7
South Dakota	3.1	24.7	13.3	32.7
Tennessee	6.4	21.8	33.3	67.0
Texas	7.5	20.9	51.3	72.1
Utah	4.9	20.6	32.8	74.8
Vermont	6.6	26.0	26.5	0.0
Virginia	6.4	20.7	35.6	76.2
Virgin Islands	--	23.6	44.0	44.6
Washington	7.5	26.2	33.0	51.0
West Virginia	11.3	26.0	28.8	0.0
Wisconsin	5.1	24.5	22.0	67.8
Wyoming	5.6	22.4	32.2	68.7
Unweighted mean	6.8	23.5	36.6	42.6

SOURCE: Column 1 from *Employment and Earnings*; columns 2 and 3 from *Unemployment Insurance Financial Data,* ET Handbook 394; column 4 provided by Tom Stengel of Actuarial Services, U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service.

The percentage of exhaustees eligible for fewer than 26 weeks is zero in the uniform duration states and is below 5 percent in three additional states—Kentucky, Louisiana, and Pennsylvania. However, in thirty states, over half of all regular exhaustees were eligible for fewer than 26 weeks of benefits, and in seven of these over three-quarters of all regular exhaustees were eligible for fewer than 26 weeks of benefits. Clearly, large proportions of regular UI exhaustees are eligible for fewer than the "standard" 26 weeks of benefits.

Table 6.4 Impacts of the Potential Duration of UI and the Unemployment Rate on the Exhaustion Rate and Percentage of Exhaustees Drawing Fewer Than 26 Weeks of Benefits, 1992

	Dependent variable	
Independent variable	**Exhaustion rate**	**Percentage of exhaustees drawing fewer than 26 weeks**
Average potential duration of UI benefits	-1.80	-11.81
	(.56)	(0.92)
Total unemployment rate	3.17	-2.52
	(.76)	(1.24)
Constant	56.66	337.99
	(13.28)	(21.69)
R^2 (adjusted)	.299	.787
N	51	51

NOTES: OLS estimates using state-level data for 1992. Standard errors in parentheses. Data are displayed in table 6 3.

The link between the proportion of regular exhaustees eligible for fewer than 26 weeks of benefits and the generosity of state duration provisions can be seen more clearly in the last column of table 6.4, where we have regressed the proportion of exhaustees drawing fewer than 26 weeks on the average potential duration of benefits and the total unemployment rate, again using the state data in table 6.3. States with higher average potential duration of benefits have a lower percentage of regular exhaustees drawing fewer than 26 weeks; a one-week increase in average potential duration is linked to a nearly 11 percentage point drop in the percentage of regular exhaustees drawing fewer than 26 weeks, controlling for the unemployment rate. States with higher total unemployment rates have *lower* percentages of exhaustees

drawing fewer than 26 weeks, which reflects the rise in long-term unemployment (and hence in 26-week exhaustees) that accompanies increases in the unemployment rate.

The regressions in table 6.4 illustrate the linkages between measures of regular UI exhaustion and both the generosity of duration provisions (represented by the average potential duration of benefits in a state) and labor market factors (represented by the unemployment rate). The average potential duration of benefits in a state plays a strong role in explaining both the regular exhaustion rate and the percentage of exhaustees who draw fewer than 26 weeks of benefits.

Based on this discussion, what are the pros and cons of using the regular exhaustion rate as a criterion of the adequacy of the potential duration of regular benefits? The main drawback of the regular exhaustion rate is its dependence on both labor market conditions and state benefit duration formulas. This mutual dependence makes it difficult to determine what an appropriate target for the regular exhaustion rate should be. Although short-run changes in the exhaustion rate may serve as an indicator of increasing or decreasing duration adequacy, even these short-run changes may be contaminated by cyclical variations in the UI take-up rate.

Also, as discussed in the first section of this chapter, there is a link between weekly benefit amounts and the potential duration of benefits that implies a trade-off between the two. For example, two states that both limit total benefits to one-third of base-period earnings (that is, $a = 0.33$ in table 6.1) will have much different average potential durations—and hence exhaustion rates—if one provides low weekly benefit amounts (and hence longer potential durations) whereas the other provides high weekly benefit amounts (and hence shorter potential durations). The regular exhaustion rate does not take account of the trade-off between the weekly benefit amount and the potential duration of benefits.

Finally, there is considerable empirical evidence that unemployment duration—and hence the exhaustion rate—can increase with increases in either the potential duration of benefits or in the generosity of weekly benefit amounts. However, if exhaustions rose due to greater UI generosity, we would clearly not want to interpret that increase as an indication that UI benefits had become less adequate.

These drawbacks notwithstanding, the intuitive appeal of the exhaustion rate is so strong that it will undoubtedly continue to be a widely used indicator of duration adequacy. In particular, the secular increase in the exhaustion rate, which has occurred during a period when both weekly benefit amounts and potential durations were being reigned in, is a rather clear indicator that the potential duration of regular UI benefits has become less generous in the last 15 years.

Experience of Exhaustees

As already noted, the regular exhaustion rate itself may or may not provide a meaningful measure of whether benefits are of adequate duration. A high regular exhaustion rate could, of course, reflect difficulty in gaining reemployment due to slack demand, but it could also reflect the disincentive effects of UI benefits on job search, among other things. The experience of UI exhaustees has been used to gain insight into which of these factors—supply or demand—is more important in generating exhaustions.

The length of time between benefit exhaustion and reemployment is a potentially useful gauge of the experience of UI exhaustees and duration adequacy. Table 6.5 summarizes what is known about the reemployment experience of UI exhaustees, based on four studies that have been conducted since the mid-1960s. Only one of these studies, the Atlanta-Baltimore-Chicago-Seattle (or "four-city") study from the mid-1970s, was performed during a time when labor markets were slack (Nicholson and Corson 1976). The others were done during nonrecessionary times (Burgess and Kingston 1979; Corson and Dynarski 1990; Murray 1974).

In all four studies, one-half or more of the exhaustees remained jobless 12 weeks after exhausting their benefits. However, the main inference to be drawn from these studies is that UI exhaustees are much less likely to find reemployment during recessionary times than during nonrecessionary times. That is, the percentages of workers reemployed at 4, 8, and 12 weeks are similar in the Pennsylvania, Arizona, and twenty-state studies but are much lower in the four-city study (the only study that drew a sample of claimants who exhausted their benefits during a recession).

Less is known about the experience of exhaustees more than 12 weeks after benefit exhaustion. Only the Pennsylvania and twenty-state

Table 6.5 Summary of Selected Studies of UI Exhaustees: Percentage of Exhaustees Reemployed after Benefit Exhaustion

	Pennsylvania, 1966-1967			Atlanta-Baltimore-Chicago-Seattle, 1974-1975					
		Duration of unemployment prior to exhaustion		White		Nonwhite			
Weeks since exhaustion	All	Under 29 weeks	29 weeks or more	Men	Women	Men	Women	Arizona, 1976-1977	Twenty-state survey, 1987-1989
2				5.6	5.3	3.5	2.3	11.5	18
4	24.5	32.9	17.9	11.1	9.8	6.1	5.3	18.3	24
6				15.2	12.5	8.5	7.9	24.4	31
8	33.0	43 0	25.1	18.7	15.3	10.1	9.9	30.2	35
10				21.9	18 9	14.4	11.9	37.0	40
12	35.5	45.7	27.5	25.3	20.8	18.4	13.5	40.0	44
14				27.0	23.7	20.3	15.5	42.1	48
16	37 5	49.1	28.1						51
22									57
26	36.4	49.5	25.8						61
34	35 6	47.5	26.0						67
44	35.6	45.4	27.6						72
48									75
52	36.5	44.0	30.4						
Sample size	11,511	5,039	6,472	493	561	375	303	235	1,920

SOURCE Pennsylvania data from Murray (1974, table 5); Atlanta-Baltimore-Chicago-Seattle data from Nicholson and Corson (1976, tables V 8 and V.9), Arizona data from Burgess and Kingston (1979, table II.7), twenty-state data estimated from Corson and Dynarski (1990, figure III 6).

studies give data on the status of longer-term exhaustees, and comparing the two gives very different impressions of the percentage of exhaustees who remain jobless 6 months to one year after exhaustion. In each case, however, the percentage still jobless 6 months to one year after exhaustion is substantial.

The Pennsylvania study shows that there are variations in the reemployment experiences of exhaustees whose pre-exhaustion spells of unemployment were relatively short or long. Also, the four-city study shows differences in the reemployment experiences of white and nonwhite exhaustees and of men and women. The differences between white and nonwhite exhaustees are less pronounced than those between men and women.

Mainly because each has sampled a group of exhaustees at a single point in time, the studies leave unanswered whether UI exhaustees' difficulties in gaining reemployment are the result mainly of high unemployment, structural changes in the economy, inadequate regular benefit entitlement, or a combination of these. Further research, especially on how the experience of exhaustees changes over the business cycle, could be extremely useful.[9] Indeed, without such studies, the appropriate remedies for the reemployment problems of UI exhaustees—or whether remedies are needed—will remain unclear.

One obvious approach, increasing the potential duration of benefits, is actually more difficult than it appears on the surface, even if there were agreement that it would be appropriate. There are two main ways of lengthening the potential duration of benefits. The first is to change the duration formula in a variable duration state so that more workers are eligible for 26 weeks of benefits. This can be done by increasing the parameter a in table 6.1 so that a higher fraction of base-period earnings can be recovered during a benefit year with a given weekly benefit amount. The second is to increase the maximum regular benefit duration beyond the usual 26-week limit. This approach presents several issues: how far the maximum should extend beyond 26 weeks; whether benefits past 26 weeks should be available to all or only to those with substantial employment history; whether such benefits should be offered at all times, or only during a recession; whether the financing of benefits beyond 26 weeks should be a state, federal, or a shared responsibility; and how regular benefits beyond 26 weeks

should interrelate with the permanent federal-state system of extended benefits. These issues are discussed further below.

The alternatives to increasing potential duration are retraining, relocation, or other (less costly, usually administrative) assistance to improve reemployment prospects. Because retraining generally requires income support during the period of training, it is extremely costly. Accordingly, the U.S. Department of Labor has opted for "profiling," the attempt to identify workers who are likely to exhaust their benefits and to refer them to relatively inexpensive reemployment services. Profiling with job search assistance can be viewed both as an effort to assist workers in gaining reemployment and (equally) as an effort to sort workers by their degree of commitment to gaining reemployment.[10] For example, evidence from at least two studies suggests that requiring workers to obtain reemployment services as a condition of continued UI benefit receipt induces some to drop out of the labor force and others to find reemployment even before the required services are provided (Corson, Long, and Nicholson 1985; Johnson and Klepinger 1991).

Profiling could change the character of exhaustees by weeding out those who are weakly attached to the labor force and by helping many of the rest to gain reemployment more quickly. Accordingly, profiling could change the nature of the problems faced by those who do exhaust their UI benefits. It follows that implementation of profiling will, if anything, increase the need for further research into the problems faced by exhaustees in gaining reemployment. Finally, for profiling to work, the demand for labor must be strong enough to absorb the workers who receive reemployment services. The need to discern whether exhaustees' troubles in gaining reemployment stem from slack demand or other sources will remain.

Work Disincentives

UI has come to be viewed as a program of trade-offs and balances: worker versus employer interests, federal versus state authority, and benefit adequacy versus work disincentives. The program's goal of providing adequate benefits may collide with the objective of preserving work incentives if the benefits are so generous that they reduce workers' motivation to gain reemployment.

The effect of UI on the duration of insured unemployment has been the subject of many studies in the last 25 years, although the impact of increasing weekly benefit amounts has been analyzed more often than has the impact of increasing the potential duration of benefits. Table 6.6 provides a summary of selected studies that have examined the relationship between the potential duration of benefits and the duration of various measures of unemployment. The table indicates the data used in each study, the summary estimate (or range of estimates) of the impact of an additional week of potential duration of UI benefits on the duration of unemployment, and provides remarks on the estimating technique.

It is clear that the estimates vary widely, from 0 in three cases to 0.9 in one case. This range, taken literally, would suggest that a 13-week benefit extension could have no impact on the expected duration of unemployment of workers, or could increase the expected duration of unemployment by nearly 12 weeks (13 weeks times 0.9). From the viewpoint of policy, such a wide range is not especially helpful. What factors can account for this dispersion of estimates?

First, as is almost always true in economic research, the data available to study the impact of potential duration on the expected duration of unemployment have limitations. Most of the studies summarized in table 6.6 have used UI administrative records, which are an excellent source of data on benefits and the duration of *insured* unemployment but do not track workers beyond their spell of insured unemployment. As a result, observed spells of unemployment are censored at the potential duration of benefits.

There are econometric methods for dealing with such data, although none is wholly satisfactory. A full treatment of these techniques and their various strengths and weaknesses is beyond the scope of this discussion, but it seems that studies that use UI exit rate models obtain lower estimates of the impact of increases in the potential duration of benefits than do studies that use maximum likelihood (including Tobit) duration models.[11] Given that the UI exit rate models impose less onerous distributional assumptions, they should probably be given greater weight than the other estimation methods.[12]

Second, the relationship between potential duration and the probability of reemployment (and hence the duration of unemployment) may vary with the tightness of the labor market. Even if an additional week

Table 6.6 Selected Estimates of the Impact of Increased Potential Duration of UI Benefits

Study	Data	Change in weeks of unemployment from 1 added week of potential UI	Remarks
Classen (1979)	UI claimants in Arizona and Pennsylvania, 1967-1969	0 - 0.12	Tobit duration estimates
Newton and Rosen (1979)	UI recipients in Georgia, 1974-1976	0.6	Tobit duration estimates
Katz and Ochs (1980)	Current Population Survey, individuals in 26 states, 1968-1970 and 1973-1977	0.17 - 0.23	Maximum likelihood duration esimates
Moffitt and Nicholson (1982)	Recipients of EB and FSC, 15 states, 1975-1977	0.1	Labor supply model, maximum likelihood estimates
Moffitt (1985a)	Continuous Wage Benefit History, 1978-1983	0.15	UI exit rate estimates
Moffitt (1985b)	Continuous Wage and benefit History, 1978-1983:		UI exit rate estimates
	White men	0.17	
	White women	0 10	
	FSC and EB recipients in 15 states, 1975-1978:		Maximum likelihood duration estimates
	Men	0.45	
	Women	0.28	
	UI recipients in Georgia, 1974-1976:		Maximum likelihood duration estimates
	Men	0.17	
	Women	0.37	
Solon (1985)	UI claimants in Georgia, 1978-1979	0.36	Maximum likelihood duration estimates

Study	Data	Change in weeks of unemployment from 1 added week of potential UI	Remarks
Ham and Rea (1987)	Canadian men, 1975-1980	0.26 - 0.35	UI exit rate estimates
Grossman (1989)	Continuous Wage and Benefit History, individuals in 3 states, 1981-1984	0.9	UI exit rate estimates of FSC impacts on UI exhaustees
Katz and Meyer (1990)	Continuous Wage and Benefit History, men in 12 states, 1978-1983	0.16 - 0.20	UI exit rate estimates
Davidson and Woodbury (1995)	UI recipients in:		Translation of reemployment bonus impacts using equilibrium search model
	Illinois 1984-1985	0.2	
	Pennsylvania 1988-1989	0 - 0.2	
	Washington 1988-1989	0 - 0.2	

of benefits had the same effect on the intensity of a worker's job search regardless of the state of the labor market, that given change in search intensity would translate into a different reemployment probability depending on the availability of job offers. There have been few attempts to estimate how the impact of an additional week of potential duration varies with labor market conditions (but see Wandner 1975). There is a real need for further investigation of this issue.

Third, some studies have focused on the impact of increasing the potential duration of regular benefits, others have focused on the impact of EB, and still others have focused on the impacts of emergency extensions such as Federal Supplemental Benefits and Federal Supplemental Compensation. There is some evidence that the impacts of EB and emergency extensions are greater than the impacts of increasing the potential duration of regular benefits, but further work sorting out the various impacts and the reasons for them would clearly be useful.

Finally, there may simply be greater variation in the behavior of workers than economists are accustomed to considering. This is suggested, for example, by results derived from the reemployment bonus experiments, all of which were similarly designed, implemented, and monitored, but which nevertheless yielded results that varied over a substantial range (Davidson and Woodbury 1996).

If we eliminate the estimates that are obtained using duration models, then we significantly reduce the variation in the estimates. The exceptions are Grossman's study (1989), which differs from the others because it examines the impact of increasing the potential duration of benefits of workers who have already exhausted regular benefits, and Ham and Rea's study (1987) of the Canadian UI system, which differs in a variety of ways from the U.S. system. With these exceptions, all of the UI exit rate estimates are in the range of 0.1 to 0.2. Similarly, Moffitt and Nicholson (1982) obtain an estimate of 0.1 week, and translating the reemployment bonus impacts using an equilibrium search model yields estimates in the range of 0 to 0.2 (Davidson and Woodbury 1996). On the whole, then, the evidence suggests that increasing the potential duration of UI benefits by one week increases the expected duration of unemployment by one day (0.2 week) or less.

Optimal Unemployment Insurance

Efforts to use economic and econometric methods to gauge the optimal duration of UI benefits are relatively few and recent. Although the studies reviewed in this section have yet to point unambiguously toward conclusions about the optimal duration of benefits, the approach holds out hope of generating recommendations that are based on clearly articulated assumptions and observed behavior. Since benefit adequacy is reviewed in chapter 5, we focus on recent analyses that bear closely on the potential duration of benefits.

O'Leary's work on benefit adequacy (forthcoming) uses consumer theory informed by econometric estimates of the trade-off between income and leisure and concludes that short spells of unemployment are overcompensated by UI, whereas long spells are undercompensated. O'Leary's result stems from the assumption that the marginal utility of leisure diminishes. That is, an additional week of leisure (in the form of unemployment) has a far higher value to someone who

works 50 weeks in a year (and has just 2 weeks of leisure) than to someone who works only 26 weeks in a year (and has 26 weeks of leisure). It follows that a much smaller weekly benefit amount is needed to compensate a worker for the first few weeks of unemployment (since the leisure implied by those first weeks is itself more valuable) than is needed to compensate a worker for later weeks of unemployment. However, since the weekly benefit amount is generally constant over the spell of insured unemployment, early weeks of unemployment (and short spells) are more fully compensated than are later weeks (and long spells).

Although the logic of O'Leary's findings is clear, the implications for policy are somewhat less so. Whenever there is moral hazard, as with UI, full compensation for the occurrence of a risky event is undesirable, since it raises the probability of the event (or its continuation). If the disincentive effect (that is, reduced job search intensity) of an additional week of potential benefits increases with the length of a spell of unemployment, then raising the weekly benefit amount as a spell of unemployment lengthens might be unattractive. The implications of raising the weekly benefit amount as a spell lengthens would need to be examined in a model that takes account of both the benefits and costs of doing so. An alternative way of correcting the overcompensation of short spells would be to extend the waiting period. This has the additional attraction of freeing funds that could be used to finance benefits beyond the usual limit of 26 weeks, in order to correct the undercompensation of long-term unemployed workers. Again, however, the implications of doing so need to be explored in a model that takes account of the response of unemployed workers to the proposed change in the pattern of unemployment compensation.

Gruber (forthcoming) has pointed out that appraising benefit adequacy by comparing UI benefits with pre-unemployment income is appropriate only if workers have no access to other sources of income, such as savings, loans, or the labor supply of other household members. If alternative income sources exist, then UI may substitute for the other ways of financing a spell of unemployment, crowd them out, and have no real effect on consumption. This insight highlights the importance of examining whether UI actually smoothes consumption, that is, whether unemployed workers who are eligible for more generous UI

benefits experience smaller drops in consumption than do workers who are eligible for less generous UI benefits.

Gruber obtains conflicting results on whether UI smoothes consumption. Using data from the Panel Study of Income Dynamics, he finds quite strong evidence of consumption smoothing, whereas using data from the Survey of Consumer Expenditures, he finds far weaker evidence of smoothing. The latter result suggests that UI does crowd out other ways of financing a spell of unemployment, whereas the former result suggests that it does not. Until this empirical issue is resolved, it will be important to examine whether findings about benefit adequacy and optimal UI programs are sensitive to assumptions about the ability of workers to save and borrow, and the willingness of other members of the household to work more when the principal earner is unemployed.

We turn next to work on optimal UI that takes an equilibrium approach and incorporates both the benefits and costs (including those resulting from induced changes in behavior) of the UI system. There was a flurry of interest in this approach in the late 1970s—the contributions of Baily (1978) and Flemming (1978) are considered the classic treatments—although its complexity seems to have stalled further development. From our perspective, it is especially important that both Baily and Flemming assumed the potential duration of UI benefits to be infinite and derived an optimal replacement rate based on that assumption. Clearly, this assumes away the problem with which we are most concerned: the optimal potential duration of benefits.

Recently, Davidson and Woodbury (forthcoming) have extended the work of Baily and Flemming to examine the optimal potential duration of UI.[13] Surprisingly, they find that the optimal UI program is characterized by an infinite potential duration of benefits. The argument is as follows. Let WBA denote the weekly benefit amount and let T denote the potential duration of benefits. Suppose that we compare two UI programs (WBA_1,T_1) and (WBA_2,T_2) with $WBA_1 > WBA_2$ and $T_1 < T_2$ so that the second program offers lower benefits but a longer potential duration of benefits. Suppose further that these two programs cost the same amount to fund so that employed workers earn the same after-tax wage under the two programs. Then it can be shown that all risk-averse workers prefer the second program even though weekly benefit amounts are lower. The second program is preferred because the

reduced probability that workers will exhaust their benefits more than offsets the reduction in weekly benefits. In the terminology of decision making under uncertainty, the second program is "less risky" than the first program and is therefore preferred by all risk-averse agents. Alternatively, to use the terminology that Rothschild and Stiglitz (1970) introduced in their classic paper on increasing risk, the second UI program, with longer potential duration and lower benefit amount, is a "mean-preserving spread," which reduces the risk associated with unemployment. Since the optimal UI program offers benefits indefinitely, while most states offer benefits for only 26 weeks, the model's results suggest that the potential durations in the U.S. system may not be generous enough.

Three remarks on this potentially controversial result need to be made. First, a likely objection to the finding that an infinite potential duration of benefits is optimal is that, if benefits were inexhaustible, workers would never return to work. It is true that lengthening the potential duration of benefits would lead workers to remain unemployed longer and to a higher unemployment rate. Davidson and Woodbury (forthcoming) show that increasing the potential duration of UI benefits from 6 months to an unlimited period with a UI replacement rate of 0.5 would raise the unemployment rate from 7 percent to 10 percent. However, this is not a shut down of the economy: workers would not collect UI benefits paying a replacement rate of 0.5 (or 0.75) forever. Also, the increase in the unemployment rate would result from voluntary behavior, not from economic hard times, and would connote an improvement in workers' well-being.

A second, more serious, objection is that extending benefits and lowering the benefit amount reduce the aggregate search effort of unemployed workers, which in turn could reduce employment. Lower employment would mean reduced tax revenues, so that the total amount paid to the unemployed would drop. If this occurred, the costs of the new program could outweigh its benefits (which stem mainly from reduced risk). It turns out, however, that this chain of events would not take place. The reason is that the reduction in aggregate search effort is almost fully offset by a change in the distribution of search effort across the spell of unemployment. That is, with a longer potential duration of benefits, search effort becomes more evenly distributed across the spell of unemployment, and this increases equilib-

rium employment. Davidson and Woodbury provide a simulation showing the net effects of the change in aggregate search effort and the change in the distribution of search effort: as the potential duration of UI benefits rises, unemployment rises by such a small amount that any loss in tax revenue is dominated by society's savings in aggregate search costs (the benefit of reduced aggregate search effort). Hence, changes in search effort do not erase the result that the optimal potential duration of benefits is infinite.

A third possible objection is that Davidson and Woodbury assume UI-eligible workers to be homogeneous; it is unclear whether the result that the optimal potential duration of benefits is unlimited is sensitive to this assumption. In future work, it will be important to consider that some UI-eligible workers may be weakly attached to the labor force, that some workers have a high probability of layoff with a low expected duration of unemployment (as do many blue-collar production workers), and that others face a low probability of layoff with a longer expected duration of unemployment (for example, white-collar nonproduction workers). It is an open question whether an unlimited potential duration of benefits would remain optimal in a model that accounts for these various types of workers.

Extended Benefit Programs

When unemployment rates rise in the wake of a recession, spells of unemployment tend to lengthen and more workers exhaust their UI benefits, that is, more workers experience spells of unemployment that exceed their potential duration of UI benefits. Whether these lengthened spells of unemployment occur because job separation rates rise or because reemployment rates fall is unimportant. As long as the lengthened spells result from slack demand and employer behavior (rather than from voluntary worker behavior), there is a justification for increasing the potential duration of UI benefits.

On six different occasions, beginning in 1958, Congress has reacted to slack labor markets by providing a limited number of weeks of federally financed "extended" benefits to workers who had exhausted their regular state benefits. In addition to these six temporary or discretion-

ary programs, Congress in 1970 established a permanent or "standby" extended benefits program (under the Extended Unemployment Compensation Act), which in principle is activated automatically by conditions of high unemployment. The following discussion provides a brief history of the six temporary programs and of the standby extended benefits program.[14] We also discuss the three most controversial issues surrounding extended benefits: how these benefits should be activated, whether additional qualifying and eligibility conditions should be required, and how such benefits should be financed. Finally, we recommend two changes in extended benefit policy based on the evidence and discussion.

Federal Extended Benefit Programs: A Brief History

Currently, the maximum potential duration of unemployment benefits provided by regular state programs ("first-tier" programs) is 26 weeks in all states except Massachusetts and Washington, where the maximum potential duration is 30 weeks (see table 6.1 and the accompanying text). In ten states, the potential duration of benefits is 26 weeks for all claimants who qualify for any benefits (Illinois and New York are the only large states that provide such "uniform potential duration" of benefits). In every other state, the potential duration of benefits varies with a claimant's work experience in the base period, roughly the year preceding the claim for benefits (again, see the first section of this chapter).

Table 6.7 provides a summary of the main features of the six federal programs that have temporarily extended the potential duration of unemployment benefits beyond the duration provided by state programs. The permanent standby Extended Benefit program (EB) is also summarized in the table. The standby EB program has come to be called the "second tier" of the UI system, and temporary emergency extensions have come to be called the "third tier" of the system.

The first two federal temporary benefit extensions, Temporary Unemployment Compensation (TUC) and Temporary Extended Unemployment Compensation (TEUC), were enacted in 1958 and 1961. They were similar in that each lasted slightly over a year and extended the potential duration of benefits to workers who exhausted their regular state benefits by 50 percent, up to a maximum of 13 extra

Table 6.7 Federal Extended Unemployment Benefit Programs, 1958 to 1995

Program and enabling legislation	Effective dates and extensions	Potential duration of extended benefits provided	Financing	Notes
Temporary Unemployment Compensation Act, P L 85-441	6/58 - 7/59	50% of regular state duration, up to 13 weeks	Interest-free loans to 17 participating states	State participation voluntary
Temporary Extended Unemployment Compensation Act (TEUC), P.L. 87-6	4/61 - 6/62	50% of regular state duration, up to 13 weeks	Temporary increases in Federal Unemployment Tax (.4% in 1962, .25% in 1963)	
Extended Unemployment Compensation Act of 1970 (EB), P.L 91-373, with major amendments in P.L. 96-364, P.L. 96-499, P.L 97-35, P.L 102-318	8/70 to present	50% of regular state duration, up to 13 weeks	One-half from Federal Unemployment Tax revenues paid to Extended Unemployment Compensation Account (EUCA); one-half from state UI reserves	EB activated in a state by an insured unemployment rate (IUR) trigger, 8/70 to present; EB could be activated in all states by a national IUR trigger, 8/70 to 8/81. Effective 1981, EB denied to claimants refusing to seek or accept suitable work and to claimants who had quit or been discharged. State triggers were made more restrictive 8/81. Eligibility for EB made more restrictive, effective 9/82. States permitted to adopt a total unemployment rate (TUR) trigger, 6/93

Emergency Unemployment Compensation Act, P.L. 92-224 and P L. 92-329	1/72 - 9/72, extended to 3/73	50% of regular state durations, up to 13 weeks	Extended Unemployment Compensation Account (EUCA)	State-level triggers (different from EB triggers) used to activate program
Federal Supplemental Benefits (FSB), P.L. 93-572, P L. 94-12, P.L 94-45, P.L. 95-19	1/75 - 12/76, extended to 1/78	50% of regular state duration, up to 13 weeks (1/75-2/75 and 5/77-1/78); additional 50% of regular state duration, up to 13 weeks provided 3/75-4/77 (that is, up to 26 weeks of FSB total)	Repayable advances to EUCA from general revenues; general revenues after 3/77	EB program was activated in all states, so total potential benefit duration was 65 for those exhausting EB weeks between 3/75 and 4/77 State-level triggers applied starting 1/76. Uniform federal eligibility and disqualification standards implemented 4/77 (P L. 95-19)
Federal Supplemental Compensation (FSC), P.L 97-258, P.L. 97-424, P.L. 98-21, P.L 98-135	9/82 - 3/83, extended to 9/83 and 3/85	FSC-I (9/82-1/83): 50% of regular state duration, up to 6 or 10 weeks FSC-II (1/83-3/83): 65% of regular state duration, up to 8 or 16 weeks FSC-IV (10/83-3/85): same as FSC-III, except entitlement did not vary once established	General revenues	Potential duration varied with state's EB status and separate FSC triggers. Except in FSC-IV, potential duration would vary when state's EB or FSC status changed FSC-I and FSC-II exhaustees could collect FSC-III benefits, but not FSC-IV benefits. EB eligibility criteria applied to all phases of FSC. Available regular state benefits and EB (if activated) had to be exhausted to receive FSC

(continued)

Table 6.7 (continued)

Program and enabling legislation	Effective dates and extensions	Potential duration of extended benefits provided	Financing	Notes
Emergency Unemployment Compensation Act of 1991 (EUC), P.L 102-164, P.L. 102-182, P.L. 102-244, P.L. 102-318, P.L. 103-6, P.L. 103-152	11/91 - 6/92, extended to 7/92, 3/93, 10/93, and 2/94	EUC-I (11/91-2/92). lesser of 100% of regular benefits, or 13 or 20 weeks EUC-II (2/92-7/92): lesser of 130% of regular benefits, or 26 or 33 weeks EUC-III (7/92-3/93)· lesser of 100% of regular benefits, or 20 or 26 weeks EUC-IV (3/93-10/93): lesser of 60% of regular benefits, or 10 or 15 weeks EUC-V (10/93-2/94): lesser of 50% of regular benefits, or 7 or 13 weeks	EUC-I, EUC-II, and EUC-III from Extended Unemployment Compensation Account (EUCA), EUC-III and EUC-IV from general revenues	Potential duration determined at time of filing for EUC and depended on state's classification as high- or low-unemployment EUC entitlement could be increased if state moved from low to high status, or if program became more generous, EUC entitlement could not be decreased. Claimants exhausting benefits between 3/91 and 11/91 could receive benefits under "reach-back" provisions (but no retroactive benefits paid) EB eligibility criteria applied to all phases of EUC. Once EUC was exhausted, a claimant needed to regain regular UI eligibility to receive additional EUC

weeks. They differed, however, in that TUC was a voluntary program financed by interest-free loans to 17 participating states. TEUC, on the other hand, was mandatory and was financed through increases in the federal unemployment tax.

If one accepts the need for extending benefits in a recession, then relying on temporary emergency extensions such as TUC and TEUC is clearly suboptimal. Temporary extensions are discretionary rather than triggered automatically. It takes time for Congress to recognize the onset of a recession and to enact legislation in response, so there may be a significant lag between the onset of slack labor markets and the availability of extended benefits. Also, temporary extensions have proven politically difficult to shut down, as we show below, so they are both slow to turn on and slow to turn off. Finally, temporary emergency extensions have usually been made effective on the date of enactment, leaving UI administrators little or no time to implement the new program.

In recognition of these problems with temporary extensions, in 1965 and 1966 Congress considered a proposal to create a permanent (or "standby") extended benefits program. The proposal was modeled on earlier temporary programs, in that it extended the potential duration of benefits by 50 percent, up to 13 weeks, for workers who exhausted their regular state benefits. However, the extended benefits would have been "triggered" automatically in a recession (rather than requiring congressional discretion and action) and would have been financed half-and-half by the states and the federal government. (Recall that regular UI benefits are financed out of state UI trust funds, whereas TEUC and most subsequent emergency extended benefits have been financed out of the federal UI trust fund.)

Although the proposal for a permanent standby extended benefits program failed in 1966, Congress enacted essentially the same proposal in 1970 as the Extended Unemployment Compensation Act, generally known as the Extended Benefits program, or EB. The intent of the permanent "standby" EB program was and is to extend automatically the potential duration of benefits when the economy slumps into recession, rather than to rely on a reaction from Congress. EB extends benefits to claimants who exhaust their regular state benefits by an amount equal to one-half of their regular benefit duration, up to 13 weeks. The weekly benefit amount is the same as the weekly benefit

amount under the regular state program. Originally, EB was activated nationally whenever the national insured unemployment rate (IUR) averaged at least 4 percent for 13 weeks. Also, it was activated in a given state whenever the state's IUR averaged at least 4 percent for 13 weeks and was 20 percent above the state IUR of the corresponding 13-week period in either of the two previous years. The EB program is financed half-and-half from the federal and state UI trust funds. In the next part of this section, we discuss the activation (or "triggering") of EB, special qualifying and eligibility requirements, and financing.

States were allowed to adopt EB as early as October 1970 and were required to do so no later than January 1972. Even before EB became available in all states, however, Congress enacted the third temporary extension under the Emergency Unemployment Compensation Act (sometimes called "Temporary Compensation" or "TC"), which provided up to 13 weeks of extended benefits to claimants who either exhausted EB or exhausted regular benefits in states where EB was not available. Temporary Compensation was activated by special triggers that differed from the standby EB triggers. It was financed from Federal Unemployment Tax Act (FUTA) revenues. The program, which originally was set to run from January 1972 until September 1972, was extended through March 1973.

During the severe recession of the mid-1970s, the national trigger activated EB in all states, permitting workers to receive up to 26 weeks of regular unemployment benefits followed by up to 13 weeks of EB. Nevertheless, the recession was so severe that Congress enacted the fourth temporary emergency extension in January 1975, Federal Supplemental Benefits (FSB), which provided up to 13 additional weeks of benefits to those who exhausted regular benefits and EB.

In March 1975, the FSB program was extended and made more generous by providing yet another 13 weeks of benefits. As a result of this and further extensions of FSB, a claimant could receive up to 65 weeks of unemployment benefits for the period March 1975 through March 1977: 26 weeks of regular state benefits, 13 weeks of EB, and 26 weeks of FSB.

In April 1977, FSB was extended again (through January 1978), but the potential duration of benefits was reduced to 13 weeks from May 1977 through the end of the program. This extension also added special federal disqualifications for refusal of suitable work and for failure to

actively seek work, defined suitable work for the FSB program, and added special penalty and repayment provisions for fraudulent acts on the part of both claimants and employers. This was the first time such disqualifications had been imposed as part of a temporary emergency extension.

In 1980 and 1981, Congress passed three changes that made it more difficult for the EB program to activate. First, the trigger that had activated EB nationally was eliminated. Second, the IUR needed to activate EB on a state-specific basis was increased. Third, the definition of insured unemployment was revised so as to omit EB claimants from the computation, reducing the IUR in times when EB was activated. In addition, more stringent eligibility and disqualifying conditions were imposed on EB claimants. All of these changes reflected a changed attitude toward extended benefits, one that reflected the intent of the new Reagan administration and Congress to reduce domestic programs. Corson and Nicholson's analysis (1985) concluded that the 1981-1982 changes in EB "had the effect of significantly reducing its overall size" (p. vii). Subsequent events suggest a stronger conclusion—that the changes virtually disabled the program.

Nevertheless, the parade of emergency unemployment benefit extensions continued in response to later recessions. In 1982, Congress enacted Federal Supplemental Compensation (FSC) as part of the Tax Equity and Fiscal Responsibility Act of 1982. FSC was different from previous emergency extended benefit programs in that the number of weeks payable in each state varied according to different criteria at different times. In fact, FSC went through four "phases," each of which provided different potential benefit durations for each state depending on the state's labor market conditions (see table 6.7, under "potential duration of extended benefits provided"). Under phase II, a UI claimant in a high unemployment state could be eligible for up to 55 weeks of benefits: 26 from the regular state program, 13 from EB (assuming the state had triggered on), and 16 from FSC.

Potential durations were somewhat shorter under phases III and IV of FSC, but the interstate differences in potential benefit durations were retained. Under FSC, then, there was more tinkering (or, more charitably, greater effort to fine-tune the program) than under previous emergency extensions in two senses. First, the idea that emergency extensions should provide different potential benefit durations to dif-

ferent states was wholly new. Second, the various phases of FSC led to frequent changes in potential benefit duration and created administrative difficulties for the states. Both of these aspects of FSC began to call into question the role of emergency extensions and seemed to be an admission that the standby EB program was already defunct.

The most recent emergency extension of unemployment benefits, Emergency Unemployment Compensation (EUC), was enacted in November 1991 after months of foot-dragging by the Bush administration, which had vetoed several earlier emergency extensions. EUC was the most complicated emergency benefit extension of all: it went through *five* phases, provided different potential durations across states at a given time, and had different potential durations within a state over time (see table 6.7 and Storey and Falk 1993). The potential duration of benefits within a state could change either because of congressional fiat (that is, a movement from one phase to another), or because a state changed its classification between high unemployment and low unemployment. By all accounts, EUC was a state UI administrator's nightmare. In Pennsylvania, for example, the potential duration of benefits changed *nine* times between November 1991, when EUC became effective, and February 1994, when phase V of EUC terminated. Five of these changes resulted from enactment of EUC or a movement from one phase to another, and four resulted because Pennsylvania was reclassified from low unemployment to high unemployment or vice versa. At one point, Congress let EUC lapse, but subsequently resuscitated it, and during the hiatus, state administrators and UI claimants were left hanging.

Activating Extended Benefits

We have already treated the rationale for limiting potential duration, the experience of exhaustees, the work disincentives of extending the potential duration of benefits, and the idea of optimal UI. These issues are important to the potential duration of regular and extended benefits alike. However, three issues are specific to extending benefits during a recession: how extended benefits should be activated, whether additional qualifying and eligibility conditions should be required for extended benefits, and how extended benefits should be financed. We

discuss extended benefit triggers first and then turn to the latter two issues.

Activating Extended Benefits: National and State-Level Triggers

When the EB program began, extended benefits could be activated either nationally or on a state-specific basis. The national "trigger" activated the program in all states whenever the seasonally adjusted national IUR reached 4.5 percent for 13 weeks. The state-specific trigger activated the program in a state whenever a state's IUR reached 4 percent for 13 consecutive weeks and was at least 20 percent above the average state IUR of the corresponding 13-week period in either of the two previous years.

As shown in table 6.7 (see notes to Extended Unemployment Compensation Act of 1970), in 1980 and 1981, the national trigger was eliminated and the state-level trigger was raised from an IUR of 4 percent to 5 percent. In addition, the definition of the IUR was revised to exclude workers receiving extended and supplemental benefits, lowering the IUR. These changes made it less likely that EB would be activated in a recession. Combined with secularly falling insured unemployment rates, resulting mainly from decreased participation in UI,[15] the changes of 1981 led to a situation in which EB was nearly defunct by the time of the recession of the early 1990s. In fact, EB was activated in only 10 states during that recession and failed to be activated in several states where many observers felt labor market conditions were bad enough to warrant it.[16]

The decreasing availability of EB during recessions would seem to have been exactly the outcome desired by Congress in the early 1980s. However, in response to the failure of EB to be activated widely during the early 1990s recession, a later Congress passed legislation in July 1992 (and effective June 1993) allowing states to adopt an alternative trigger based on the total unemployment rate (TUR), that is, the conventionally defined unemployment rate estimated monthly by the Current Population Survey. The alternative trigger activates EB in a state if the state's three-month average TUR exceeds 6.5 percent and is 10 percent above the three-month average TUR in either of the two preceding years.

It is clear that, during the recession of the early 1990s, the alternative TUR trigger would have activated EB in many more states than did

the old IUR trigger (Advisory Council on Unemployment Compensation 1994, chapter 6). The old trigger activated EB in ten states for an average of 6.2 months, resulting in benefit payments of $.9 billion. If the alternative TUR trigger had been in effect in all states throughout the recession, EB would have been activated in forty-three states for an average of 18.4 months, resulting in benefit payments of $11.8 billion.[17] Hence, nationwide adoption of the alternative TUR trigger would largely solve the problem of EB becoming defunct.

However, only seven states have adopted the alternative TUR trigger, and all did so shortly after the legislation was enacted. No additional state has since switched to the new TUR trigger. This suggests that the states are unwilling to take on the burden of funding even partially the second-tier or standby extended benefit program. Rather, they would prefer to rely entirely on temporary emergency extensions, wholly financed by the federal government.

During congressional debate on whether to extend the Emergency Unemployment Compensation program in 1992 and 1993, Republicans in Congress argued that if Congress continued its pattern of enacting emergency extensions whenever the economy went into recession, there would be no incentive for the states to switch to the new alternative EB trigger (that is, the trigger that is based on the TUR). Indeed, states have stalled in adopting the new TUR trigger because they do not really want EB to be activated in a recession. The old IUR trigger has become ineffective and rarely activates EB, whereas the alternative TUR trigger would be more effective. States, however, naturally prefer to have the federal government step in and provide emergency extended benefits, since emergency benefits have been financed wholly by the federal government. In contrast, only half of EB payments are financed by the federal government; the other half is financed out of states UI trust fund accounts. As long as the states can argue that EB is not providing adequate benefit durations, they can reasonably urge Congress to enact emergency extensions. Furthermore, as long as Congress accommodates the states with emergency extensions, the states have no incentive to switch to the alternative TUR trigger, which would be more effective but would also result in greater benefit payments from state UI trust funds.

A cynic might argue that Congress really does not want the standby EB program to work effectively, either—that members would prefer to

step in and enact an emergency program whenever the economy slumps. An emergency program shows that Congress has "done something" in an economic downturn and offers the politicians a concrete program to point to when they stand for reelection. Such a cynical view may not be wholly unrealistic: the alternative TUR trigger *would* activate extended benefits in a recession (unlike the IUR trigger), and Congress *could* require the states to switch to the alternative TUR trigger. However, Congress has not done so.[18]

Activating Extended Benefits: Substate Triggers

An additional issue that has been considered repeatedly in Congress is substate triggers, that is, allowing EB to be activated in a depressed local area *within a state*, rather than requiring that EB be activated throughout a state when conditions in the entire state are severe enough. The logic underlying this notion is that, from the standpoint of labor markets, state boundaries may be quite arbitrary. There may be large differences in labor market conditions between urban areas within states (consider, for example, Philadelphia and Pittsburgh, or Los Angeles and San Francisco) or between the urban and rural parts of a state. Isn't it unfair to deny extended benefits to unemployed workers who live in a region that is experiencing high unemployment simply because they happen to live in a state where—overall—the unemployment rate is too low for the EB program to be activated? Wouldn't substate triggers allow more effective targeting of benefits to workers who are having real difficulty finding reemployment?

The arguments against adopting substate EB triggers are many and include considerations of administration, equity, and unavailability of appropriate data, as well as concerns about whether such a program would meet its intended goals (Czajka, Long, and Nicholson 1989; Advisory Council on Unemployment Compensation 1994, chapter 6). A major administrative stumbling block would be defining appropriate areas within states. Bills proposing the use of substate area triggers have provided a variety of regional definitions, including areas designated by the Secretary of Labor as contiguous population centers of at least 250,000, of at least 50,000, any county or equivalent of a county, any area designated as a Service Delivery Area under the Job Training Partnership Act, and any area designated as an economic area by the Bureau of Economic Analysis in the Department of Commerce.[19] As a

geographical unit for activating EB, it is unclear whether any such local area would be less arbitrary than the state. Also, it is unclear whether individuals would be assigned to an area based on place of work or on place of residence. Whatever definitions of substate regions were adopted, it is clear that the potential for fraud would be greater and that it would be more difficult and costly to determine eligibility and process interstate (and interarea) claims. All of these issues raise concerns about the equity of substate triggers, since triggering EB in local areas could make it more likely that similar individuals facing similar labor market conditions and living near each other would receive different EB entitlements.

Another major problem in implementing substate triggers would be obtaining data for the substate triggers themselves. Accurate indicators of labor market conditions in each local area of the country are simply unavailable at present. The accuracy of substate TUR estimates is highly suspect. Data on employment levels are available only in 250 metropolitan areas and would need to be developed for places outside those areas. Developing either the TUR or local area employment statistics so that they could be used as an EB trigger would be difficult and costly.

Finally, in the most complete study of substate triggers, Czajka, Long, and Nicholson (1989) conclude that, although a substate program could be designed so as to improve the targeting of UI benefits to workers in slack labor markets during *non*recessionary times, the potential improvement in targeting during a recession is small. In other words, most of the increased benefit payments under a program of substate triggers would be made during nonrecessionary times, and the basic goal of a substate program, improved access to extended benefits during a recession, would not be achieved.

State boundaries have long been accepted for triggering extended benefit programs because the state has always been the basic operational unit for UI. Serious unemployment in local areas is clearly an appropriate concern of state and local governments, but it is more appropriately addressed through local economic development programs, or perhaps through individual state experiments with UI, than by means of the EB program (which has a significant federal component). Also, as discussed, the existing standby EB program no longer responds even to statewide unemployment problems because the old

IUR trigger no longer activates the program and states have dragged their feet in adopting the new TUR triggers. Fixing the existing EB program is clearly a more urgent priority of federal UI policy than trying to fine-tune the program to deal with the problems of localities.

Conclusions on Extended Benefit Triggers

The future of the EB program and emergency extensions is quite unclear at this time. Congress seems to pay attention to the UI system only when there is a recession, so the role of politics would seem to be more important than the role of economic (or any) analysis in determining the future of extended benefits. It needs to be noted that relatively little effort has been devoted to understanding what is (or would be) the socially optimal potential duration of benefits or to analyzing the extent to which the optimal potential duration should change with changing labor market conditions. These gaps, convincingly addressed, could have an impact on policy and on the future direction of extended unemployment benefits. Notwithstanding the gaps in our understanding of the optimal potential duration of benefits, we develop two sets of recommendations for extended benefit policy in the last part of this section.

Further Issues in Extended Benefits

Qualifying and Eligibility Requirements for Extended Benefits

In addition to making it more difficult for EB to trigger on, the 1980 and 1981 amendments to the standby EB program made eligibility for EB more restrictive. Whereas originally, all UI exhaustees were eligible for available extended benefits, the program now requires that workers have at least 20 weeks of work (or the equivalent) in the base period to qualify for EB.

The 1980 and 1981 amendments also require EB claimants to actively search for work and require the disqualification of EB claimants who failed to accept or apply for suitable work or training to which they were referred by the state Employment Service. This disqualification is for the duration of unemployment.[20]

The prevailing motivation behind the amendments was to reduce the size of the program, and the appeal for their enactment was made largely on that basis. It was also argued that the claimants affected

were long-term unemployed persons lacking in initiative and hence less deserving of extended benefits (Rubin 1983, p. 115).

What are the merits of increasing the eligibility requirements for EB and of requiring EB claimants to satisfy the work search test? The research on benefit adequacy and optimal UI outlined in the second section of this chapter offers support for providing EB to all workers who exhaust regular UI when EB is in effect. Three arguments do favor setting more stringent eligibility requirements for extended benefits than for regular benefits, although their merits are debatable. The first is that individuals who have worked longer (and whose employers have contributed more) should have greater entitlement to benefits. Second, setting more stringent eligibility requirements for EB than for regular benefits reduces the financial cost of EB. Third, more stringent eligibility requirements for EB may limit the moral hazard of EB. For this third argument to be persuasive, there would need to be evidence that the work disincentive of an additional week of EB is greater for some workers—those who appear to be less strongly attached to the labor force—than for others. We are unaware of any such evidence, however.

Requiring EB claimants to satisfy a more stringent (and uniform) federal work search test makes little sense if indeed there are few job vacancies during periods when EB is activated. State UI administrators and employers alike would prefer to waive the work search test for EB in regions where it is clear that job vacancies are scarce. Imposing the work search test in such regions has little value and is costly to both administrators (who are expected to enforce the requirement) and to employers (who may get job inquiries from claimants who are merely trying to satisfy the work test without any serious hope of gaining reemployment). These findings are reflected in one of the recommendations of the Advisory Council on Unemployment Compensation, which suggested that "Each state should be allowed to determine an appropriate work search test, based on the conditions of its labor market" (Advisory Council on Unemployment Compensation 1994, p. 12).

Financing Extended Benefits[21]

There are three main issues in financing extended benefits: first, whether extended benefits should be funded out of payroll taxes (as are regular benefits) or from federal general revenues; second, whether extended benefits should be financed by the states, by the federal gov-

ernment, or by some combination of the two; and third, if EB is funded from a payroll tax, whether that payroll tax should be experience rated (as it is for regular benefits). A complete treatment of these issues would require a more detailed discussion of UI financing than is appropriate in this chapter. Briefly, though, regular benefits are funded fully by the states through a payroll tax that is experience rated (that is, dependent on each employer's past layoff experience) and collected on a taxable payroll limited to less than $15,000 a year (per worker) in all but eleven states.[22] This method of financing UI benefits creates economic incentives for firms to behave in ways that they otherwise would not. First, experience rating of the payroll tax reduces temporary layoffs and limits the extent to which employers in seasonal and cyclically sensitive industries are subsidized by employers in more stable industries (see Brechling and Laurence 1995, Levine's chapter 8 in this volume, and Topel 1990 for discussions and further references). Second, the cap on taxable payroll skews employers' demand for labor away from low-wage, less skilled workers and in favor of high-wage, more skilled workers. Also, the payroll tax cap creates an incentive for employers to assign extra hours of work (that is, overtime) to their existing work force rather than to hire additional workers.

Whether extended benefits should be funded by a payroll tax or by general revenues depends mainly on issues of tax equity. The available evidence suggests that the UI payroll tax is shifted partly to workers in the form of lower wages and partly to consumers in the form of higher prices. The part that is shifted to workers can be viewed as regressive, since low-wage workers bear a disproportionate share of the payroll tax as a result of the low taxable wage base. (This regressiveness would be blunted if low-wage workers received a disproportionate share of the benefits, which seems likely.) The part that is shifted to consumers can be viewed as proportionate if we assume that people with different incomes consume a mix of goods and services on which average UI taxes do not differ. On balance, then, the UI payroll tax is probably somewhat regressive (Hamermesh 1977, pp. 10-15). Federal general revenues, on the other hand, are somewhat progressive, given that (apart from social security payroll taxes) over 70 percent of those revenues are generated by the federal personal income tax. Tax equity, then, gives a slight edge to general revenues over payroll taxes as a funding source for extended benefits.

However, the overall question of tax equity ignores the issue of state-federal sharing of extended benefit expenses: should extended benefit payments that are made in a state be paid for by that state, by the federal government, or by some combination of the two? Currently, half the benefits under the EB program are paid out of the Extended Unemployment Compensation Account, which is funded from FUTA revenues (that is, the flat 0.8 percent of taxable payroll that the federal government charges for administration, extended benefits, and repayable advances). State UI trust fund reserves pay for the other half. Most emergency extensions, however, have been financed entirely from federal revenues, either from the EUCA or (increasingly) from general revenues (see table 6.7).

The existing state-federal sharing of EB funding appears to have wide acceptance and is based on the rationale that long-term unemployment is likely to be the result of macroeconomic conditions (both national and international) over which individual employers have little or no control (Murray 1974, chapter 5). Federal sharing of EB expenses, then, is a way of providing some assistance to states that are suffering disproportionately from long-term unemployment.[23] In addition, federal sharing has been seen as a way of reducing the resistance of states (and employers) to extended benefits. Although there appears to be no comprehensive economic analysis of the costs and benefits of federal sharing of EB funding, the arguments seem to favor the federal government assuming more, rather than less, of the funding burden for extended benefits.

There is no empirical evidence on whether experience rating of benefits paid under EB has the beneficial effects that have been estimated for experience rating of the regular program.[24] Obtaining such evidence would be difficult, given that the EB tax is such a small percentage of the overall UI tax. However, it seems likely that increasing the experience rating of EB would be far less beneficial than would increasing the experience rating of regular benefits. The main reason is that, although employers do have considerable discretion over the timing and incidence of temporary layoffs, they may have much less discretion over the incidence of permanent job losses, which often lead to long-term unemployment. Also, it has been argued that spells of unemployment that last beyond 26 weeks result more from general macroeconomic conditions than from the actions of a specific employer. As a

result, there seems to be less scope for experience rating to have a positive effect in the case of EB than in the regular UI program, and less justification for its use in financing EB.

The Advisory Council on Unemployment Compensation (1994, pp. 11-12) recommended that any expansion of extended benefits be financed by raising the taxable wage base under the federal UI payroll tax (FUTA) from $7,000 to $8,500.[25] The Advisory Council believed that the two most attractive funding sources for EB are federal general revenues and FUTA, which is neither state-specific nor experience rated. Because the taxes that produce federal general revenues may be somewhat more progressive than the federal UI payroll tax, federal general revenues may have an advantage. However, the Advisory Council opted for reducing the regressiveness of the UI payroll tax by recommending an increase in the taxable wage base.[26] In any event, the Advisory Council believed the case for funding extended benefits out of an experience-rated payroll tax to be weak.[27]

Recommended Changes in the Extended Benefit Programs

The previous discussion suggests two recommendations for changes in extended UI benefit policy. First, *repair the EB triggers*. It is important that the standby EB program be made effective, so that the potential duration of benefits is lengthened in a timely manner when a recession hits. The importance of repairing the standby EB program follows from the available evidence that long spells of unemployment are underinsured and that the potential duration of regular state benefits may be suboptimal. Congress effectively disabled the triggers that activate EB in the early 1980s. Since then the program has often failed to be activated automatically in states that are experiencing slack labor markets during a recession. As a result, Congress has stepped in with increasingly complicated emergency programs that have significantly lagged the onset of recession, have been ad hoc in design, and have been difficult to administer. Compared with a well-designed standby EB program, these emergency programs have been far less effective in providing countercyclical stimulus and have been slower to provide benefits to unemployed workers.

Several recommendations have been advanced for repairing the triggers that activate the standby EB program. For example, a majority of

members of the Advisory Council on Unemployment Compensation recommended that EB should be activated when a state's seasonally adjusted TUR exceeds 6.5 percent (Advisory Council on Unemployment Compensation 1994, p. 10). Similarly, as discussed, it is clear that several Republican members of Congress see adoption of the alternative TUR trigger by all states as the way to fix the problem.[28] Which of these recommendations is adopted is less important than ensuring that one of them is adopted. The EB program, which could be an effective, efficient, and socially useful program, is now all but a dead letter.[29]

Second, *design a third-tier temporary emergency program in advance of the next recession and have it ready to implement when and if Congress perceives that the standby EB program is not providing long-enough benefit durations.* Creating a model third-tier emergency program that can be put into effect at the discretion of Congress is important as a practical matter, since Congress has shown repeatedly a penchant for passing emergency extended benefit programs (at least after a delay) when the economy sinks into a recession—and did so even when the standby EB program was activated in most states that were experiencing slack labor markets (that is, during the recessions of the mid-1970s and early 1980s). Having an emergency program designed in advance would give the states time to set up the computerized information systems that are needed to implement the program quickly and to administer it effectively. Ultimately, the administrative costs of a well-designed emergency program would be lower than the costs of repeated ad hoc programs, and workers would be better served because benefits would be received in a timely manner. In other words, the net social benefits of a predesigned emergency extended benefit program would be far greater than the benefits of a program that has an ad hoc design and needs to be implemented on the fly.[30]

How should a ready-to-implement third-tier program be designed? We believe that there are three essential elements to such a program, which might be called the Federal Emergency Extended Benefits program. First, provide federal emergency benefits only in states in which the standby EB program has been activated, and only to workers who have exhausted both their regular and standby extended benefits. There are two main reasons for this feature of a federal emergency program. First, it would direct extended benefits to workers who face the most difficulty obtaining reemployment. Second, it would ensure that the

standby EB program is taken seriously, that is, that effective EB triggers are established and maintained. Relatedly, it would create an incentive for states to adopt the alternative TUR trigger for EB (if it were not mandated by Congress), since federal funding for emergency benefits would be received only if EB were in effect. By ensuring the maintenance of an effective EB program, paying federal emergency benefits only to EB exhaustees would eliminate the need to implement "reach-backs" as part of emergency extensions.[31] If Congress preferred to provide extended benefits to all states in a recession, it would be appropriate first to reestablish the national trigger for the EB program. Consideration could then be given to providing federal emergency benefits to all states based on a similar national trigger for the federal emergency program.

Second, finance federal emergency benefits wholly out of federal revenues, either from FUTA funds or from general revenues. Federal funding of emergency extended benefits is in keeping with the widely accepted notion that increasingly long spells of unemployment, especially when induced by a recession, are more and more a federal responsibility (Murray 1974).[32]

Third, incorporate some bounded flexibility in the number of additional weeks of benefits provided by the federal emergency extended benefit program. Starting with the Federal Supplemental Benefits program (1975-1978), Congress has provided additional weeks of benefits in relation to the unemployment rate in a state. For example, under the Emergency Unemployment Compensation (EUC) program (1991-1994), each state was classified as either "high unemployment" or "low unemployment" based on its total unemployment rate. The number of weeks of emergency benefits provided in each state was then tied to the state's classification as "low" or "high" unemployment. Similarly, a ready-to-implement federal emergency program should provide for longer benefit extensions in states where conditions are worse. However, it is essential that there be flexibility in the number of weeks of benefits provided and in the unemployment rate that triggers each increment to extended benefits each time the program is enacted or reenacted. This would allow Congress to take account of current conditions and of changes in the relationship between UI exhaustions and the unemployment rate. Also, Congress would retain the sort of discretion it clearly prefers in fashioning extended benefit programs.[33]

Nevertheless, Congress should place two types of bounds on its flexibility in providing federal emergency benefits. First, for the purpose of determining how many weeks of these benefits to offer, states should be classified into at most two or three categories based on their total (quarterly) unemployment rate. For example, under EUC, states were classified as either high or low unemployment. Two or three categories should be enough, particularly if emergency extended benefits are provided in increments of eight or more weeks, as Corson, Grossman, and Nicholson (1986) suggest in their study of Federal Supplemental Compensation. Second, a state's assignment to a high or low unemployment classification should be on the basis of a calendar quarter, and Congress should not allow itself to change the number of weeks of emergency benefits provided to states in a given classification within a calendar quarter. In other words, it should be impossible to change the number of weeks of emergency benefits provided in a given state during a current calendar quarter. This recommendation is consistent with the findings of Corson, Grossman, and Nicholson (1986), who considered both administrative feasibility and program effectiveness in their research.

A fourth issue, the requirements that a worker would have to satisfy in order to be eligible for federal emergency extended benefits, would also need to be settled. We have no recommendation on this point. Since 1981, the eligibility requirements for standby EB have been set at the national level. In about 15 states, the eligibility requirements for EB are significantly more stringent than for regular state benefits, and, as a result, significantly fewer workers are eligible for EB than for regular state benefits. The available empirical evidence suggests that there is only a weak relationship between the characteristics that determine UI eligibility and a worker's expected duration of unemployment (Corson and Nicholson 1982, pp. 102-106; Pozo and Woodbury 1988). That is, using tighter eligibility requirements for EB than for regular state benefits reduces program expenses but does not screen out and deny benefits to workers who are weakly attached to the labor force. This supports dropping the uniform federal eligibility requirements for EB (and for any ready-to-implement federal emergency program) and allowing each state to set the eligibility requirements for all forms of UI benefits, first-, second-, and third-tier. On the other hand, an argument could be made that if federal revenues finance a program, the

associated eligibility requirements should be set at the federal level. These arguments for and against setting eligibility requirements for EB and emergency benefits on a national basis would need to be weighed in fashioning a Federal Emergency Extended Benefits program.

The preceding recommendations for a ready-to-implement emergency extended benefit program are not intended merely to make the lives of UI administrators easier—although they would do that. Rather, such a program would result in more timely payment of emergency benefits to workers and would provide greater counter cyclical stimulus than past emergency extended benefit programs have done.

Some Provisional Conclusions

The adequacy of UI benefit duration has been debated since the beginning of the system, and the accepted norm for the potential duration of benefits, as expressed in policy, has changed significantly over the decades. When the program began in 1935, most states provided a maximum potential duration of 15 weeks of benefits. This norm gradually rose, until by 1979, the maximum potential duration of benefits was 26 weeks in most states and exceeded 26 weeks in twelve states. Augmenting this upward trend were the standby EB program, which came into existence in 1970, and a parade of temporary emergency benefit extensions. Both EB and the emergency extensions provided additional weeks of benefits during hard times. During the 1980s, the trend reversed, so that today, the maximum potential duration of regular state benefits is 26 weeks in all but two states. Also, in 1981 and 1982, Congress effectively scaled back the EB program. Whether this trend will continue or again reverse itself is to be seen. Pushing toward longer benefit durations are increasing concerns over dislocated workers and job insecurity; pushing toward shorter durations is the political obsession with reducing government programs without regard to social costs or benefits.

It seems fair to say that, as with other government programs, research and analysis have played a regrettably limited role in setting and changing the duration of UI benefits. There has, of course, been significant work on the disincentive effects of extended benefits (see

the summary in table 6.6), and the U.S. Department of Labor has commissioned evaluations of the three most recent emergency extended benefit programs (Corson and Nicholson 1982; Corson, Grossman, and Nicholson 1986). However, it is also clear that the research thus far has not fully addressed some of the major issues that need to be investigated in forming policy on the duration of benefits, such as the optimal duration of benefits, how duration should change over the business cycle, and the merits of EB triggers other than the IUR and TUR. Whether further research along the lines described in the second section of this chapter will converge on a convincing and clear set of recommendations is yet to be seen, but the work that has been completed to date suggests that the current focus of the UI system on compensating only relatively short spells of unemployment may be unnecessarily narrow.

The findings that suggest this conclusion can be summarized as follows. First, the UI program in the United States was defined as a program for short-term unemployment mainly out of financial and political expediency, rather than after consideration of whether permanent job loss and long-term unemployment are insurable risks. The financial argument against covering longer spells of unemployment is not nearly as persuasive today as it was in the 1930s.

Second, existing studies suggest that increasing the potential duration of UI benefits by one week increases the expected duration of unemployment by one day (0.2 week) or less. This is a relatively small behavioral effect that suggests that the average UI recipient is not abusing or taking advantage of the availability of benefits (although a sizable minority of UI recipients could be doing so).

Third, work on consumption-smoothing and benefit adequacy suggests that short spells of unemployment are overcompensated by the UI system, whereas long spells are undercompensated. Also, research on optimal duration of benefits suggests that risk averse workers would willingly accept lower benefits early in a spell of unemployment in exchange for the promise of some nonzero level of benefits should their spell of unemployment turn out to be very long. It follows that reducing benefits to short-term unemployed workers (for example, through increasing the waiting period) in order to finance benefits to long-term unemployed workers would improve social welfare. Thus, considerations of consumption smoothing, benefit adequacy, and opti-

mal insurance all suggest that it would be reasonable public policy to extend the potential duration of benefits beyond 26 weeks, perhaps even during nonrecessionary times.

These three findings apply equally to regular and extended benefits, in that they address the issue of potential duration in general. All three considerations suggest that the existing UI system has focused too narrowly on short spells of unemployment and that policy should pay greater attention to long-term unemployment. In fact, U.S. Department of Labor policy has recently moved in this direction. The UI profiling initiative is an attempt to identify new UI claimants who are likely to experience a long spell of unemployment and to exhaust their benefits. These claimants are then referred to intensive job search assistance. An alternative response would be to extend the waiting period by one or two weeks and to use the financial savings to fund a longer potential duration of regular state benefits.

Apart from setting the maximum potential duration of benefits, perhaps the most important general issue in the duration of benefits is whether potential duration should be the same for all workers who are eligible for benefits, or whether potential duration should vary with a worker's earnings prior to unemployment. This is a point that is equally significant to the regular and extended benefit programs. In the regular state program, the question is whether benefit duration should be uniform (in which case all workers who qualify for any benefits are eligible for the same potential duration) or variable (in which case recipients with different work histories are eligible for different potential durations). In extended benefit programs, the question is whether eligibility requirements should be higher for extended benefits than for regular benefits.

The research on benefit adequacy and optimal UI outlined in the second section of this chapter provides a justification for uniform potential duration of benefits to all eligible UI claimants and for provision of extended benefits (when such a program is in effect) to all workers who exhaust regular UI. In addition, it is clear that uniform duration in regular state programs results in a significant increase in the average potential duration of benefits in a state, which in turn reduces the UI exhaustion rate. The evidence suggests that the decline in average potential duration is at least partly responsible for the secular rise

in UI exhaustions and that moves toward uniform duration would help to reverse the trend.

However, there are at least three arguments for varying the potential duration of benefits with a claimant's work history and, by implication, for setting more stringent eligibility requirements for extended benefits than for regular benefits. The first is that greater entitlement should be afforded to those who have worked (and whose employers have contributed) the longest. The counterargument is that weekly benefit amounts already reflect work history, so why should potential duration do so as well? The second argument is that variable duration and more stringent eligibility requirements for extended benefits result in lower program costs. Since lower program costs would, in this case, mean lower program benefits, this is hardly a persuasive argument. It begs the question whether lowering benefits can be justified by efficiency or equity criteria. A third argument in favor of variable potential duration of benefits and more stringent eligibility requirements for extended benefits is that they are ways of limiting the moral hazard of UI. In general, of course, limiting the duration of benefits is an effort to limit moral hazard. But variable duration and more stringent eligibility requirements for extended benefits take the further step of assuming that the work disincentive of an additional week of benefits is greater for some workers, those who appear to be less strongly attached to the labor force, than for others. The implicit argument is that it is possible to discern which eligible UI claimants are weakly attached to the labor force and hence are most likely to reduce their job search effort in response to an additional week of benefits. However, we are unaware of evidence that base-period earnings (or their pattern) provide an accurate measure of a worker's labor force attachment or that the disincentive effects of an additional week of benefits are greater for workers with lower or more variable base-period earnings. It seems likely that moral hazard can be handled more effectively by a work search requirement or intensive job search assistance than by limiting the potential duration of benefits.

Finally, the potential duration, triggering, and financing of extended benefits have been among the most contentious issues in UI during much of the program's history. The main rationale for extending UI benefits during a recession is that, during a recession, spells of unemployment lengthen and the number of UI beneficiaries who exhaust

their benefits rises. As long as the lengthened spells result from slack demand and employer behavior (rather than being a result of voluntary worker behavior), there is a justification for increasing the potential duration of UI benefits. In fact, the evidence suggests that UI exhaustees are much less likely to find reemployment during recessionary times than during nonrecessionary times (see table 6.5), which tends to support the traditional rationale for extending benefits during a recession.

Work on the adequacy of extended benefits has relied primarily on the total UI exhaustion rate as a criterion for gauging duration adequacy. However, the exhaustion rate is an ad hoc criterion, since we really do not know what the "right" exhaustion rate is. Similarly, research on the merits of various "triggers" for extended benefits has been limited to comparing the amounts of benefits that would be paid under various triggers, without developing a normative framework that would provide real guidance as to which triggering mechanism would be optimal. In other words, although there has been much research on extended benefits—useful and competently done—the work has been developed without the sort of economic framework that would give convincing answers to some of the most pressing policy questions on extended benefits: What is the optimal potential duration of extended benefits? To what extent should potential benefit duration vary with changing labor market conditions? What are the best criteria for activating (and de-activating) extended benefits? What are the appropriate mechanisms for financing extended benefits?

Nevertheless, based on the existing research, as well as on pragmatic considerations, we offer two recommendations for extended benefit policy. First, we strongly recommend that the triggers for the standby EB program be repaired, so that the program will again be effective and the potential duration of benefits will be lengthened in a timely manner when the next recession hits. Second, and equally strongly, we recommend creation of a Federal Emergency Extended Benefits program in advance of the next recession. Such a program would be ready to implement when and if Congress perceived that the standby EB program is not providing sufficient benefit durations. A Federal Emergency Extended Benefits program would have three essential characteristics: it would provide federal emergency benefits only in states in which the standby EB program has been activated, and

only to workers who have exhausted both their regular and standby extended benefits; it would be financed out of federal revenues; and it would give bounded flexibility in the number of additional weeks of emergency benefits provided. Compared with past emergency extended benefit programs, such a program would be easier and less costly to administer, result in more timely payment of emergency benefits to workers, and offer greater countercyclical stimulus.

NOTES

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1 See Advisory Council on Unemployment Compensation (1995, p 129) for a discussion of replacement rates based on the administrative records of six states. Although the ACUC discussion is based on a different definition of the replacement rate (the ratio of weekly benefits to average base-period earnings) than the one used in the text, it does suggest that benefit durations in excess of base-period employment durations would imply strong work disincentives

2 In addition, the waiting period serves the same function as a deductible in a standard insurance contract Hence, it prevents very small claims (that is, short spells of unemployment) from being compensated and provides a mechanism for risk-sharing See Davidson and Woodbury (1997) and the literature cited there, especially Raviv (1979) and Shavell and Weiss (1979)

3 The amendments were part of the Omnibus Budget Reconciliation Act of 1980 (P.L. 96-499, approved December 5, 1980). See also Rubin (1983, pp 109-111)

4 See U S. Department of Labor (1995, Section 315)

5 The UI payroll tax has been used as a vehicle to finance innovative programs (such as workplace-based training) for workers affected by structural change For a review of these programs, see Leigh (1990)

6. The source for this and the next two paragraphs is U.S Department of Labor (1995)

7. *Manual of State Employment Security Legislation* (1942), Employment Security Memorandum No 13, p 313

8. The regular exhaustion rate is measured as the number of exhaustees in a given month divided by the number of initial claims for benefits that were filed six months before This is an inexact measure of the exhaustion rate because not all initial claimants who exhaust their benefits do so six months later Rather, some exhaust benefits in less than six months—for example, those whose potential duration of benefits is less than 26 weeks and who exhaust their benefits after a continuous spell of unemployment Other exhaustees take more than six months to exhaust their benefits—for example, those who experience more than one spell of insured unemployment during the benefit year

9 Given that only one of the four existing studies was performed during a recession, an additional study that sampled a group of exhaustees during a recession would be useful even if it did not continuously sample over a period of time that is long enough to include both tight and slack labor markets.

10 Profiling also reflects the view that most dislocated workers are job-ready

11 Grossman's results (1989) are a glaring exception They differ from any of the other estimates, however, because they are estimates of the impact of an additional week of emergency benefits for workers who have already exhausted their regular benefits.

12 Solving the data problems head-on might prove more satisfactory than econometric solutions to the data problems. there are ways of mitigating the limitation of administrative data, but to date these have not been pursued

13 The remainder of this section draws liberally from Davidson and Woodbury (forthcoming).

14. For a more extensive narrative account, see Blaustein (1993, pp. 200-206 and 228-241).

15 On the drop in UI participation rates, see Bassi and McMurrer (in this volume) as well as Blank and Card (1991) and Vroman (1991)

16. EB was activated during 1990 in Alaska and Rhode Island During 1991, EB was activated (in addition) in Maine, Massachusetts, Michigan, Oregon, Puerto Rico, Vermont, and West Virginia. In the first quarter of 1992, EB was activated in Louisiana. Notably missing from the list are California and northeastern states such as New York and Pennsylvania, all of which experienced a severe recession in the early 1990s

17 These estimates are from Advisory Council on Unemployment Compensation (1994, chapter 6) and are for the period January 1990 through August 1993 For comparison, during the same time period the EUC program provided extended benefits in all states for 22 months, resulting in benefit payments of $23 billion. Advisory Council on Unemployment Compensation (1994, chapter 6) and Corson and Rangarajan (1994) provide estimated impacts of a variety of alternative EB triggers

18 There is, however, a less cynical explanation of why Congress has not required the states to adopt the alternative TUR trigger If the EB trigger were effective, EB would be activated in some states even during times of low national unemployment, since labor market conditions vary substantially across the states So an ineffective EB program yields budget savings for the federal government

19 See U S House of Representatives (1985), p. 91

20 Congress suspended the disqualification for failure to search for work during 1991 through 1995, however, the disqualification is now back in effect.

21 This discussion draws on Advisory Council on Unemployment Compensation (1994, chapter 6)

22. Of the eleven states that have a payroll tax base exceeding $15,000, only one (New Jersey) is among the ten largest states See Advisory Council on Unemployment Compensation (1996, table 5-1, p 67).

23. If some states specialize in industries that tend to generate long-term unemployment, such interstate assistance could turn into interstate subsidies that have efficiency consequences.

24 In 1994, thirty-four states charged some percentage of benefits paid under EB back to the employer (Advisory Council on Unemployment Compensation 1994, chapter 6)

25 In 1996, the Advisory Council on Unemployment Compensation recommended (with some dissent) raising the payroll tax base to $9,000 and adjusting the base annually by the Employment Cost Index (Advisory Council Unemployment Compensation 1996, p 19)

26. From a political standpoint, of course, the payroll tax has the distinct advantage that it is dedicated to the payment of UI benefits.

27. In contrast to the reasoning of the Advisory Council on Unemployment Compensation, Brechling and Laurence (1995) have recently offered a theoretical case for funding the costs of permanent job loss by taxing employers who permanently reduce their employment. Brechling and Laurence argue that a socially optimal rate of adjustment can be obtained by forcing the agent who controls the rate of adjustment to pay for the adjustment costs This argument can be

extended to suggest that EB should be funded by employers who contract and are responsible for long-term unemployment. In other words, EB should be funded out of experience-rated payroll taxes, not out of general revenues. The debatable point in this argument is whether employers in contracting industries really are able to control the rate at which they contract

28. As discussed earlier in this section, the alternative TUR trigger activates EB in a state when the state's three-month average TUR exceeds 6.5 percent and is 10 percent above the three-month average TUR in either of the two preceding years

29 Once the triggers have been repaired in this basic way, attention could be paid to whether greater potential duration of benefits should be activated if the unemployment rate rose significantly above 6 5 percent For example, Hight (1975) and Corson and Nicholson (1982, chapter 5) investigated how the total UI exhaustion rate could be kept constant by triggering additional benefit extensions with increases in the insured unemployment rate They found that the exhaustion rate is held constant by adding about 3.5 to 5.1 weeks to potential duration for each 1 percentage point increase in the insured unemployment rate With a TUR trigger, the relationship between exhaustion rates and the TUR would need to be investigated

30 See Corson, Grossman, and Nicholson (1986) for a discussion of the administrative difficulties encountered during the Federal Supplemental Compensation program

31. Reach-backs have provided emergency extended benefits to workers who exhausted their benefits before adoption of the emergency extension program. For example, under the Emergency Unemployment Compensation program (1991-1994), most individuals who received reach-back EUC benefits had exhausted their regular state benefits between March and November 1991 but had never received benefits under the standby EB program With an effective EB program, these workers would already have received some weeks of extended benefits, and there would be no need for a reach-back

32 However, Brechling and Laurence (1995) have offered quite a different set of recommendations. See note 27

33. Obviously, Congress would have the discretion to ignore any ready-to-implement third-tier program and to fashion an entirely new one, as it has done (in effect) in the past However, the purpose of creating such a third-tier program is to shorten the time needed to react to a recession and to ease and rationalize administration of the program.

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