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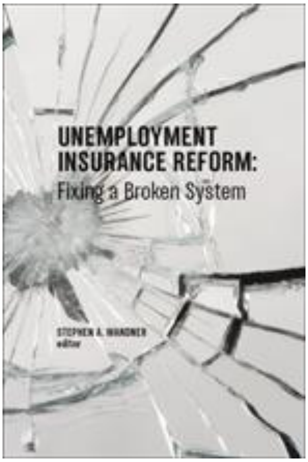
Conclusions and Needed Reforms



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Chapter 6

Conclusions and Needed Reforms

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This book has carefully examined the Unemployment Insurance (UI) system and reviewed a number of recent proposals for UI reform. All of these proposals find that the UI program requires substantial reform. The reform proposals cover a wide range of needed changes, and they suggest alternative approaches for resolving some issues. Thus, a number of approaches should be taken into consideration to implement the key reforms discussed below, and many options for change have been discussed in the earlier chapters.

The main thrust of this book is the need for comprehensive reform that creates a robust, self-sustaining UI program that restores the ability of the system to reliably provide temporary adequate income replacement during the search for reemployment. Reforms should put the UI system in balance so that benefits and taxes are in equilibrium both in the long term and over the business cycle. The UI benefit system must be adequate and reflect current labor force behavior and current economic conditions. In addition, UI taxes need to be able to pay for a robust program of UI benefits and be distributed equitably. Finally, the objective of UI is not just to provide income support to unemployed workers, but to help them return to work, so reemployment services are required for all permanently separated workers.

KEY REFORMS

Below is a list of key needed UI reforms. The list is a broad summary of reforms and is not as comprehensive as some of the proposals discussed in the previous chapters, but it outlines a framework for a sustainable, adequate, and equitable UI system to provide adequate benefits for experienced, unemployed workers.

Bring Benefits and Taxes in Balance

Today, the UI system is out of balance. The federal tax base is inadequate, and many state taxable wage bases are also inadequate. Tax rates are not necessarily adjusted to accommodate adequate benefit payment levels, and benefit levels and maximums are adjusted upward over time in some states but not others.

Strategic balancing of UI revenues and benefits has been neglected throughout the program's history at both the state and federal levels. By contrast, Social Security has dealt with this issue repeatedly and has assured that both benefit levels and the taxable wage base keep up with the cost of living. The same should be done with UI.

Regular UI Benefits

The basic regular 26-week UI system should be changed. It needs to have adequate benefit levels and benefit durations as well as reasonable eligibility conditions for workers with past attachment to the labor force before they become unemployed. And the benefit provisions should be adapted to the substantial changes that have occurred in the United States in recent decades.

Adequate benefit levels

Given the wide discretion of states to shape their state UI programs, UI benefit provisions vary greatly across the country, and they are likely to continue to do so in the future. This variation is significant enough that it creates substantial equity problems, with unemployed workers receiving widely different duration levels, even after adjusting for state differences in average weekly wages.

Proponents have argued for a benefit amount standard for seven decades. They have reached a consensus that the original proposal is the most reasonable—to set the maximum weekly benefit amount at two-thirds of each state's average weekly wage.

Adequate benefit duration

There should be a minimum of 26 weeks of potential duration. It was not previously necessary to advocate for this in the past because all states had a minimum potential duration of 26 weeks from the mid-1970s until 2010. The spread of lower potential durations in the past few years shows that such a standard is needed.

Eligibility conditions

A small number of states have significantly narrowed benefit eligibility and harshened benefit administration. States should be encouraged to avoid punitive eligibility conditions that reduce benefit recipiency below reasonable levels.

On the other hand, as a social insurance program, unemployed workers should not be eligible for UI benefits unless they have exhibited recent attachment to the labor force. To achieve this goal, O'Leary and Wandner (Chapter 5) recommend setting eligibility for minimum benefit amounts with high quarter earnings of at least $1,000 and second highest quarter earnings of at least $500.

Adjust other benefit provisions to the changing American labor force

The American labor force has changed significantly in the decades since UI was enacted in 1935. The biggest changes over the past two decades have been more multiple earners within households, a long-term increase in the participation of women, and the increased participation of older workers over the past two decades. The program should adjust to this modern labor force by implementing the following changes:

- For two-worker families, UI should pay benefits when one spouse follows the other to a new job in a new location.
- The participation of women and older workers has resulted in a sharp increase in part-time work. The UI program should allow part-time workers to collect UI while searching for part-time work.
- Older workers often have to change career jobs or move to jobs that "bridge" their transition to full retirement. These transitions require job search methods that are different from traditional job searches for similar employment. They often result in older workers taking bridge jobs that involve a decline in wages, a change in industry and occupation, or a change from full-time to part-time work, so older workers should be provided with special reemployment services to help with the search for bridge jobs and new careers.
- Because many older workers are continuing to work after leaving their long-term career jobs, the federal pension offset provision should be removed.

UI Finance

Adequate, equitable funding

Today, low wage employers pay a disproportionate share of UI taxes. They may pay UI taxes on all or nearly all of their wages paid, while high wage employers may pay taxes on only a small portion of their wage bill.

- A higher taxable wage base is needed to spread the burden among low and high wage employers, as well as to raise adequate revenue.
- The UI taxable wage base must be increased considerably, such that it equals between one-third and one-half of the Social Security taxable wage base. It should also be indexed each year to increase at the same percentage rate as the Social Se-

curity taxable wage base. Alternatively, the UI taxable wage could be tied to the average wage in covered UI employment rather than to the Social Security wage base.

- To have a sound UI tax system, state tax schedules should be set such that no state is permitted to include a zero rate in any tax schedule so that all employers support UI system operating costs and each tax schedule includes at least 10 rates so that all employers pay UI taxes closely reflecting their unemployment experience.
- Employers tend to oppose increases in UI benefits and taxes because they pay the entire tax. UI research, however, indicates that the incidence of the UI tax falls, in part, on workers through reductions in their total compensation, that is, wages plus benefits. The UI tax should change from an employer tax to a joint employer-employee tax, with employees paying half or more of the tax so that employees have increased ownership in the UI program.

Countercyclical funding

- To have a countercyclical financing system, forward funding is needed. The Unemployment Trust Fund should have adequate reserves before a recession. UI taxes should not be increased at the beginning of a recession. State accounts in the Unemployment Trust Fund should be restored after a recession is over and before the next recession begins.
- States need to adhere to the appropriate tax schedule under their state law, without any legislative deferral of movement to higher schedules, subject to loss of UI offset credits. State tax schedules need to be selected annually based on maintaining or achieving adequate state system reserves.
- U.S. Department of Labor reserve requirements should guide states in attaining reserve adequacy.

- Building an adequate trust fund can be facilitated by either requiring states to reach an adequate level of reserves or by providing states with a financial incentive for building their reserves to a specified level. Both approaches have been recommended by UI reform proposals, and both would improve system solvency.

Administrative financing

The administration of the UI, Employment Service (ES), and other federal-state labor market programs is funded from the Federal Unemployment Tax Act portion of the UI tax. Federal funding pays for program administration, extended benefits, and loans to states—each with its own account. For many years, states have faced severe funding problems in the administration of these programs, and it has become more severe over time. The balances in the federal accounts have been inadequate, and Congress has appropriated a declining percentage of the tax revenues that are deposited into the administrative account.

Whereas the payment of UI benefits is an entitlement and does not require appropriations from Congress, the payment of administrative funds to the state agencies for UI and Wagner-Peyser Act programs is discretionary and must be appropriated. Congress should fully fund UI and ES administration. Appropriation levels for UI should fully reflect benefit payment, benefit integrity, and tax collection costs. Appropriations for ES should be greatly increased, bringing appropriations back to the 1984 level in real terms—a time when ES funding was more adequate.

Extended Benefits

- Although Congress will always want to have the final say about benefit duration extensions during recessions, it often is slow to take action. The United States needs an automatic system of benefit extensions that works in a timely fashion.

- Extended benefits (EB) are not insurable. They should not be treated like the regular 26-week program and should be funded from general federal revenues.
- Existing EB triggers don't work. They should be replaced with a new trigger mechanism that uses the total unemployment rate rather than the insured unemployment rate. The number of weeks of EB should vary with the unemployment rate, so that EB is sensitive to the severity of recessions.
- More specifically, recent EB program proposals reviewed in this book propose to improve the EB trigger mechanism by making use of the total unemployment rate and having multiple levels of EB durations from 7 to 54 weeks. EB should be paid 100 percent by the federal government, either from the Unemployment Trust Fund or from general revenue.

Reemployment Services and the Work Test

The work test is crucial for having the UI program remain as a social insurance program. The ES provides the work test under federal law, ensuring that UI recipients are able, available, and actively searching for work. The service also refers UI recipients to jobs and provides them with labor market information.

- Reemployment services are critical in a world with few temporary layoffs and many permanently displaced unemployed workers. The UI and ES programs need sufficient funding to provide displaced workers with intensive, in-person job search assistance.
- Job search assistance and other reemployment services have been shown to be highly cost effective in promoting return to work and shortening durations of UI benefit receipt. Nonetheless, UI claimants receive inadequate reemployment services both because of general underfunding of ES and because of inadequate and declining funding of UI reemployment services.

O'Leary and Wandner (Chapter 5) recommend restoring ES funding to its 1984 level in real terms.

- Other reemployment and unemployment prevention services can speed the return to work of UI recipients by expanding their use in short-time compensation and self-employment assistance programs, and by enacting a program of targeted reemployment bonuses. New federal legislation would be needed to make reemployment bonuses a legal use of Unemployment Trust Fund reserves.

CONCLUSION

Public policy toward the UI program has been neglectful for many decades. Much of the program is broken and requires major reform now. Both states and the federal government should adopt policies and legislation that can restore the program to be consistent with its original intent. Otherwise, the system will be inadequate in the future, particularly when it is needed during the next recession.

This book has reviewed a number of recent comprehensive UI reform proposals. The proposals present alternative approaches for improving the program. Policymakers should conduct a comprehensive review of the UI program and options for change, including the various proposals considered in this book.

Unemployment Insurance Reform

Fixing a Broken System

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