4-1-2020

Reforming Unemployment Insurance

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Citation

O'Leary, Christopher J. 2020. "Reforming Unemployment Insurance." Policy Brief. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.

W.E. UPJOHN INSTITUTE

MARCH 2020

POLICY BRIEF

Reforming Unemployment Insurance

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BRIEF HIGHLIGHTS

- *Over the past 40 years, the UI system has deteriorated in many states.*

- *Comprehensive UI reform is needed because of Congressional neglect, policy failures by state and federal governments, and U.S. economic and demographic changes.*

- *Benefits exceeding revenue from taxes has left a structural imbalance in the overall UI program.*

- *There are vast differences across states in UI recipiency rates, wage replacement rates, and taxable wage bases.*

- *Benefits should be accessible, adequate, well financed, and delivered in concert with robust reemployment services.*

For additional details, see the working paper at https://research.upjohn.org/up_workingpapers/317/.

The federal-state unemployment insurance (UI) program exists to provide temporary partial wage replacement to workers who are unemployed through no fault of their own while they actively search for work. It is intended to operate as a self-financing social insurance program with sufficient reserves to pay adequate benefits for reasonable durations. However, revenues in several states have eroded over time to the point that many have allowed wage replacement rates to fall and others have cut benefit durations. Yet, as the average duration of unemployment has increased in the United States, there has been a growing need for *increasing* benefits.

In this policy brief we describe the structural imbalances in the system and examine systemic causes for the deterioration in many states of UI as social insurance. Based on our recent review of research evidence we recommend a comprehensive program for UI system reform (O'Leary and Wandner 2018). Unlike competing recommendations that would tilt the system toward a broader social agenda, our proposal focuses on preserving UI's core role of adequate temporary income replacement for unemployed workers.

Background

There are four broad categories of factors that suggest the need for comprehensive UI reform. First, Congress has neglected the UI program, failing to update and improve its legislative framework originally established by the Social Security Act of 1935. The last major reforms of the UI program were over four decades ago, in 1976. By contrast, Congress has enacted many changes to the provisions of Social Security, and many advisory council reports have resulted in legislative updates and improvements to that program.

Second, the U.S. economy has changed significantly since the last UI reform. The industry and occupational mix of employment has shifted, as the goods-producing sector has shrunk and service-sector jobs have become more prevalent. Working at smaller, less unionized establishments, service workers are less likely to know about the UI system and how to apply for benefits, and thus less likely to receive them (O'Leary and Wandner 2020). Employers also respond differently to recessions than they did before 1976. Layoffs are now much more likely to be permanent rather than merely temporary, and the duration of unemployment has been increasing. These changes have increased the likelihood that UI claimants exhaust their benefits before they find their next job.

Third, the demographics of the U.S. labor force have changed significantly. There have been large increases in female labor force participation, and, since 1990, older individuals have steadily become more likely to continue working. Additionally, a greater share of households today consist of two or more workers. Moreover, voluntary part-time employment has become more common, fueled in part by the influx of mothers, caregivers, and older workers into the labor force. Despite these shifts, the UI program has been slow to accommodate the new demographic reality.

Fourth, policy decisions and policy failures at the federal and state levels of government have substantially weakened the UI program over the past four decades. Notably, the leadership and oversight role of the U.S. Department of Labor has weakened, leaving the states to determine the scope and nature of their state UI programs (Wandner

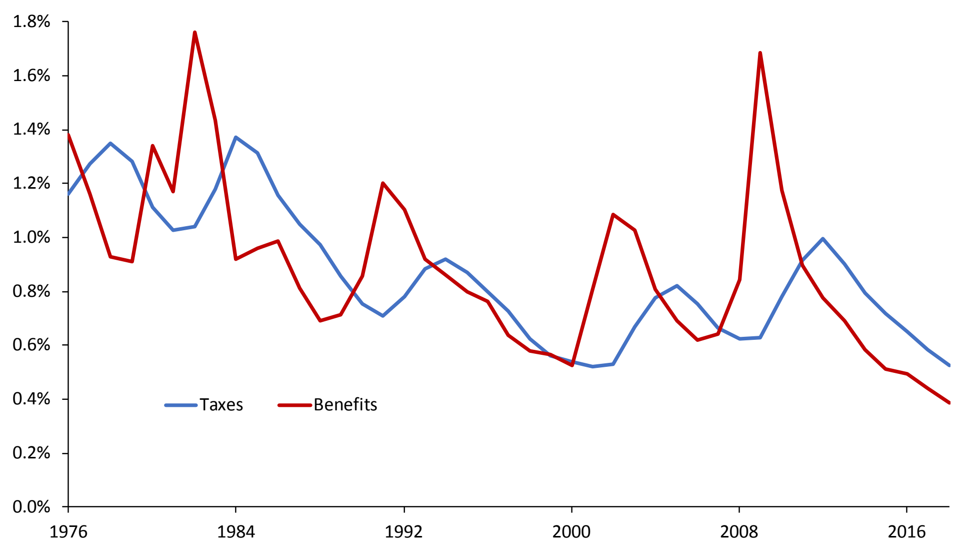
As a percentage of total payroll, both UI benefit payments and tax contributions have been declining since the last major UI program reforms in 1976.

2019). Additonally, for many years, state UI laws, programs, and policies have varied but generally have reduced benefit payment and tax collection systems.

A Structural Imbalance

As a percentage of total payroll, both UI benefit payments and tax contributions have been declining since the last major UI program reforms in 1976 (Figure 1). While layoffs occur throughout the business cycle, many more workers become unemployed during recessions. As a result, the number of unemployed workers tends to surge at the beginning of a recession and then decline rapidly as the recession ends. To support the countercyclical role of the UI system in the macroeconomy, tax contributions should rise with business expansion after a recession trough. However, many states have UI financing systems that are not responsive to reserve deficiencies. In these states, an insufficient share of earnings are taxable, employer tax rates are not sufficiently responsive to benefit changes, and legislatures have sometimes overridden tax increases triggered by low reserves. Consequently, in several states the overall financing system is out of balance, with perpetual deficits putting downward pressure on benefit adequacy.

Figure 1 Over the Past Four Decades, UI Benefits and Taxes Have Declined as a Share of Payroll



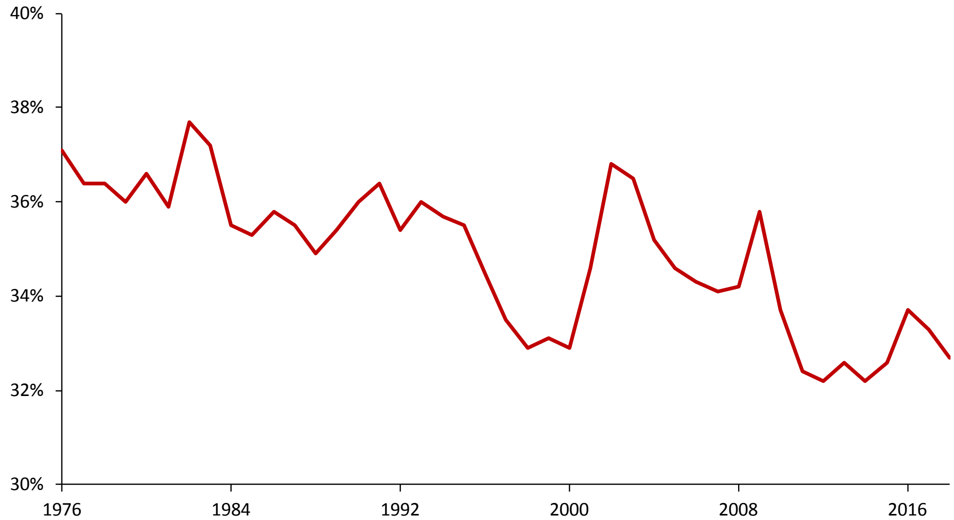
SOURCE: USDOL (2019).

Decline in Benefit Generosity

A rough measure of benefit generosity is the average wage replacement rate: the average UI weekly benefit amount divided by the average wage in a UI-covered job. Figure 2 shows the steady decline since 1976 in this measure of benefit adequacy. Most state UI benefit formulas traditionally aimed to replace about 50 percent of earnings, up to a statutory cap. The decline in the average replacement rate shown in the figure has resulted mainly from most states failing to raise the maximum weekly benefit amount to account for wage growth. Some states have also explicitly lowered the wage replacement target. Both changes have interfered with the system's core mission of temporary partial wage replacement while workers search for new jobs.

Some states provide adequate benefits and collect sufficient taxes to pay for them but most do not.

Figure 2 The Share of Wages That UI Benefits Replace Has Shrunk over the Past 40 Years

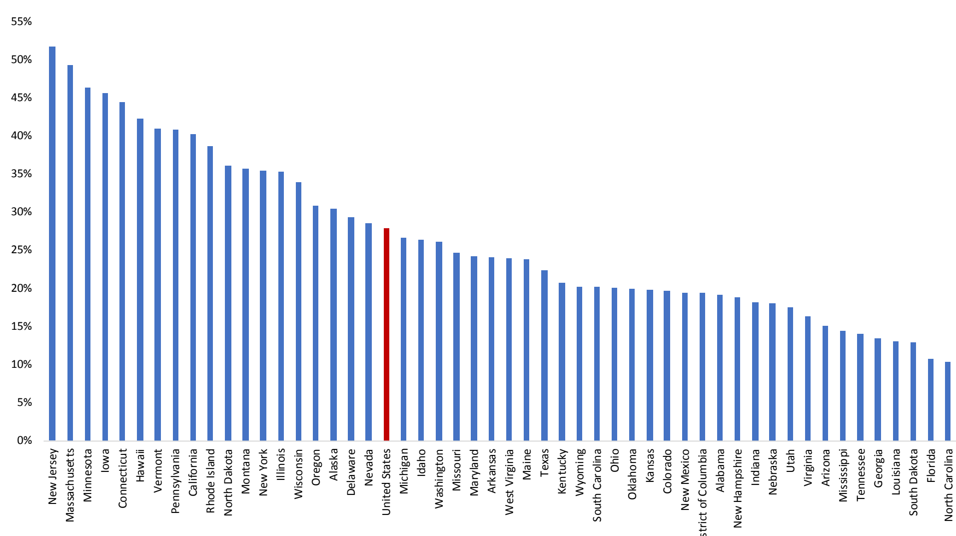


SOURCE: USDOL (2019).

Some States are in Worse Shape Than Others

The decline in the UI system has been uneven across states. While some states still provide adequate benefits and collect sufficient taxes to pay for them, most states do not. Many states have also made it more difficult to apply for and be eligible for benefits. A summary measure that captures these factors of system adequacy is the recipiency rate—the share of unemployed who receive UI benefits. Not all unemployment qualifies for UI benefits, so the recipiency rate will never be 100 percent. For example, new entrants and reentrants to the labor force do not have sufficient recent work experience to be eligible. Workers who voluntarily quit or were dismissed for cause, or who received and exhausted their benefits, also lack eligibility. However, these reasons cannot fully explain the variation in UI recipiency rates across states summarized in Figure 3. In 18

Figure 3 UI Recipiency Rates for the Unemployed Vary Dramatically across States



SOURCE: BLS (2020) and USDOL (2019).

UI application procedures should not introduce unnecessary hurdles to eligibility.

states, fewer than one of five unemployed workers receives UI benefits. With such low recipiency rates, it is hard to recognize UI as social insurance.

Principles for Reform

Several authors have recently recommended UI reforms (Von Wachter 2019; West et al., 2016), but not all of these recommendations focus on achieving the historical core mission of UI. Based on our review of the research, we propose a comprehensive menu for fixing the issues we have described here and for restoring UI as social insurance. What follows are some of the most important features of our proposal.

- *UI eligibility* should be offered to bona fide labor force members who are involuntarily separated from work and actively searching for reemployment. Application procedures should not introduce unnecessary hurdles to eligibility.
- *Benefit levels* should provide socially adequate income replacement without being so high as to discourage reemployment. Benefit durations should be long enough to accommodate an energetic and exhaustive search for new work with sufficient reemployment assistance.
- *Extended benefits*, which automatically extend durations when employment conditions are sufficiently poor, should cover up to 26 additional weeks in high unemployment periods. Additionally, the federal government should fully pay for these extended benefits for states that adequately fund 26 weeks of regular UI benefits, with the understanding that Congress may act on an emergency basis to supplement the permanent EB program.
- UI financing should be ensured by setting the UI taxable wage to a proportion of the Social Security taxable wage base, which automatically rises with wage growth. Moreover, state UI tax schedules should be fully responsive to employer benefit charges; employers with more workers who claim benefits should pay proportionately more in taxes.
- Active work search should be expected of all UI beneficiaries, and the public employment service should actively support these beneficiaries in their search.
- Special programs should be encouraged. All states should offer work sharing, in which employees get partial UI benefits when their hours are reduced even if they are not laid off, and self-employment assistance, in which workers get benefits as they try to start a business. Furthermore, states should have the option to offer UI reemployment bonuses for beneficiaries who find a new job quickly, and to experiment with wage insurance, which compensates workers who find a new job but at a lower wage than their previous job.

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Extended benefits should cover up to 26 additional weeks in high unemployment periods.

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