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Unemployment Insurance: Fix It and Fund It

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ABSTRACT

During the 2020–2021 pandemic, the federal-state unemployment insurance (UI) system in the United States nearly reached the breaking point. The surge in joblessness was matched in history only by the Great Depression of the 1930s. Congress hurriedly crafted temporary pandemic benefit assistance programs to fill benefit and eligibility gaps in state-run UI programs, handing them off to capacity-starved state UI agencies that fitfully served millions of workers and employers. After years of policy neglect and contraction, state UI programs have low benefit recipiency, meager earnings replacement rates, and inadequate benefit financing. It is time for comprehensive federal UI reform legislation, which should require state lawmakers to improve program access, benefit adequacy, financing, and reemployment services to meet the challenges of the new labor market. In this paper, the authors offer essential elements for practical UI program reform that includes explicit sharing of program costs between business and labor.

JEL Classification Codes: J65, J68, H71

Key Words: Unemployment insurance, weekly benefit amount, application, eligibility, recipiency, taxable wage base, experience rating, Federal Unemployment Tax Act (FUTA), reemployment, employment service, Wagner-Peyser Act, Social Security Act.

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In early 2020, the COVID-19 pandemic pointed a spotlight on the federal-state unemployment insurance (UI) system, revealing many shortcomings. Yet despite numerous defects, the aging state UI systems provided an essential lifeline to American workers during the health-care emergency, when 22 million jobs in the United States were suddenly lost in the first few months (BLS 2020). The unemployment rate reached 14.8 percent in April 2020. The nation had not witnessed such a paralyzing work stoppage since the Great Depression of the 1930s.[1] As in all eight previous high-unemployment periods since World War II, federal legislation extended the potential duration of benefits. The Coronavirus Aid, Relief, and Economic Security (CARES) Act, the principal federal law to combat pandemic-related joblessness, also significantly increased the earnings replacement rate because of a policy consensus that UI benefit adequacy had significantly deteriorated. In this policy paper, we argue that UI reform should encompass improved access and benefit adequacy, along with increased financing to help pay for these improvements.[2] Furthermore, standards for UI access, benefits, and financing should be specified in federal law, updating the Social Security Act (SSA) and Federal Unemployment Tax Act (FUTA) so that states are required to enact companion UI provisions in their laws.

BACKGROUND

In March 2020, the CARES Act established three new temporary federal unemployment programs: 1) Federal Pandemic Unemployment Compensation (FPUC), which supplemented

[1] The previous post–World War II high point of joblessness occurred in December 1982, when the rate of unemployment peaked at 10.8 percent—higher than the Great Recession of 2007–2009, when it reached 10.1 percent.

[2] Our list of suggested reforms relies on research by prior federal UI commissions (NCUC 1980; ACUC 1996), published research papers, and government reports.

regular weekly benefits; 2) Pandemic Emergency Unemployment Compensation (PEUC), which extended the potential duration of benefits; and 3) Pandemic Unemployment Assistance (PUA), which provided income support to those who were not eligible for regular unemployment benefits. These programs were administered by state unemployment agencies in tandem with regular UI. Together, they enabled 53 million jobless workers and their families to shelter in place, reduce the spread of the novel coronavirus, and receive income replacement until health conditions improved, employers resumed production, and workers returned to their jobs. Through existing state UI programs and federal UI supplements, $870 billion was injected into urban and rural communities to boost consumer spending and stabilize the economy (USDOL 2022).

Nonetheless, during the pandemic, state-run UI systems—the nation's first line of defense against the vicissitudes of joblessness—wobbled badly, stranding many UI claimants and causing unnecessary hardship and stress for them and their families during the worst health-care disaster in a century. Mercifully, the federal-state UI system did not wholly collapse—in large measure because of the tireless efforts of state UI civil servants working extraordinary hours. They scrambled to serve as many claimants as possible while modifying outdated computer systems. The compressed timeline of pandemic events required state UI agencies to immediately put in place untried programs in the midst of the health-care shutdown. At the same time, state agencies faced an avalanche of more than one million weekly new claims for benefits across the various unemployment programs. This went on for more than a year (Evermore 2022).

The health-care emergency laid bare, in striking fashion, the effects of insufficient federal funding for state UI and employment service (ES) delivery systems. Stagnant annual state administrative budgets had resulted in the attrition of state civil servants at local one-stop offices—designated as American Job Centers a decade ago—without replacing them (USDOL 2012). Since the 1990s, the reduced numbers of state UI and ES civil servants on duty often have been insufficient to provide in-person, one-on-one services for UI claims, job finding, and placement.[3] State agencies were compelled to rely on legacy computer technology, using electronic and telephone call-center processes that were not designed to handle massive workloads. More than 10 million jobless workers received unemployment benefits every week in the first nine months of 2021, until the supplemental federal programs expired (Raderman 2022).

For too many jobless workers, the response of state workforce agencies during the pandemic was characterized by delay, frustration and disappointment on the part of their clients. This occurred despite the efforts of state civil servants, who provided direct services to job losers, trained new temporary staff, and implemented new benefit programs, all at the same time that they themselves faced health risks as great as workers who were idled.[4] Policymakers in Washington, D.C., turned to state UI programs, whose origins lie in the industrial economy, and whose state laws in many instances have not kept pace with careers in the budding free-lance economy or the work preferences of the new workforce. As well, outdated UI application and payment systems were incapable of operating new and large-scale unemployment assistance programs without being vulnerable to payment errors, fraud, and delays.

[3] Bartik (2022) argues that economic growth in distressed areas can be spurred by providing workers with improved access and support for public transit or reliable personal transportation, child-care subsidies, and counselors who help workers overcome personal challenges to increase job retention. In our view, these companion services also are needed by other structurally unemployed workers, such as recent criminal offenders (Jenks, MacGillivray, and Needels 2006).

[4] A coauthor of this policy paper received a telephone call during dinner in late 2020 from an acquaintance who had lost her job. For several days, at all hours, she had attempted to file for weekly UI benefits remotely without success, because the state computer system was locked up. Exhausted and fearful of not complying with the state's reporting requirements, she also placed multiple calls to the telephone help desk but could not get through. The coauthor of this paper advised her to share her plight directly with the state's UI director using a publicly accessible email address. That same evening at around 8:30 p.m., a state UI staff member called her with explanations. While not everyone during the pandemic got the timely help that they expected from a government program, this story exemplifies the dedication of UI staff.

As the nation rebounds from the COVID-19 pandemic, it is high time for federal lawmakers to permanently fix the federal-state UI program, just as responsible homeowners fix leaky roofs when the sun shines, and not when the skies are pouring rain. UI reform requires patience, persistence, and education. It also requires a willingness among lawmakers to accept compromises that serve the common interests of workers, businesses, and the public. A reformed UI system should meet the requirements of the twenty-first century workforce across all states. It should provide better and easier procedures for application and eligibility assessment, strengthen financial guardrails, improve generosity, and shield against improper payments and fraud.

Expanding eligibility and increasing benefits without growing tax revenue would be irresponsible public administration. Under the Social Security Act of 1935, the founders of the UI program created a federal-state program, modeled on the compound governance structure the United States instituted in the federal Constitution. At the outset, the Social Security Act assessed employer UI taxes on all wages of workers, but in 1939, to ease recessionary pressures resulting from the economic downturn of 1937–1938, an amendment to the UI program instituted a taxable wage cap on each employee, setting the taxable wage base as the first $3,000 of covered workers' earnings (Public Law 76-379). Since then, on only three occasions, all under Republican administrations with bipartisan congressional support, has the federal taxable wage base been increased: in 1970 (P.L. 91-373), effective in 1972, to $4,200; in 1976 (P.L. 94-566), effective in 1978, to $6,000; and in 1982 (P.L. 97-248), effective in 1983, to $7,000.[5]

The UI debt accumulated by states in the early 1980s, along with a "No new taxes" posture adopted by elected officials at the federal and state levels, resulted in tighter state UI eligibility requirements (Balducchi and O'Leary 2018, p. 81). During the Great Recession of

[5] The federal UI taxable wage base matched the Social Security taxable wage base (SSTWB) until the early 1970s, when the SSTWB was indexed to the growth in average wages. In 2022, the SSTWB stood at $147,000.

2007–2008, UI modernization grants encouraged states to expand benefit eligibility in exchange for one-time cash awards. Since only some states modernized, greater overall disparity emerged in UI policies between states. After the Great Recession, some states—currently 12 in number—reduced the potential duration of benefits from a common 26 weeks. By 2019, the share of unemployed workers receiving unemployment benefits (referred to as the recipiency rate) had declined to 28.1 percent, from 54.6 percent in 1958 (Costa 2022, p. 6). In recent years, there has been insufficient tax revenue in many states to fund adequate benefits, which has resulted in states enacting laws to restrict eligibility, slow benefit increases, and reduce durations. These cutbacks, coming in reaction to deficient state revenues, outweighed indexed increases in state maximum weekly benefit amounts (WBAs), thereby eroding the purchasing power of weekly payments (Wandner 2020, p. 14).

In order for states to be required to address benefit and financing deficiencies in their laws, there must be amendments to UI provisions in the Social Security Act and the Federal Unemployment Tax Act (FUTA). While drafts of UI reform legislation have circulated in Washington, recent reform proposals in the 117th Congress neglected benefit financing. Ignoring the financial obligations of proposed benefit improvements would be an abdication by Congress of its role as a fiduciary of the UI program and the Unemployment Trust Fund.

Following enactment of the Social Security Act of 1935, the most extensive federal reform of the UI program in the annals of the federal-state partnership was the Unemployment Compensation Amendments of 1976 (P.L. 94-566). That 1976 federal law expanded UI coverage for employees of nonprofits, state and local governments, and agricultural workers.[6] It also increased the federal UI taxable wage base, which sets the minimum for state taxable wage

[6] Initial steps to expand coverage to these groups were taken in the Employment Security Amendments of 1970 (PL 91-373).

bases. Overall, the federal law increased revenue, extended coverage, modified the triggering mechanisms for the federal-state extended benefit program, refined eligibility requirements, and established a national study commission. This bicentennial-year law was the product of coalition, compromise, and consensus.

The balancing of interests to achieve a legislative consensus for present-day UI reform will require financial as well as benefit changes in a manner similar to the 1976 amendments. To help achieve that end, compromise must be an essential element, because through it, each party will obtain something to claim as a success.[7] By restoring benefit adequacy and securing the financial integrity of the UI system, the program can recapture its relevance to current and future generations of workers and employers. Rather than exploit public policy differences, lawmakers should follow a holistic approach to reform that provides adequate temporary partial income replacement to involuntarily unemployed workers seeking reemployment, and that mandates that benefits be delivered quickly and accurately.

AN AGENDA FOR UNEMPLOYMENT INSURANCE REFORM

Based on UI policy research and recommendations from past national study commissions, we offer a balanced and practical agenda for reform of federal laws governing UI access, wage replacement, and financing.[8]

Principles and Goals of UI

- UI is an essential part of the American social insurance system.

[7] This view was shared by scholars of history and politics such as Robert Remini, James McGregor Burns, and Shelby Foote, who held that compromise is a vital feature of the American government structure.

[8] In September 2022, an earlier draft of these essential reform measures was sent to members of the UI Task Force of the National Academy of Social Insurance.

- The main aim of UI is to provide adequate temporary partial income replacement during periods of involuntary unemployment by experienced labor force members while they are actively seeking reemployment.
- UI is an "earned right"—an entitlement gained through sufficient prior work.
- UI is neither a dole nor means-tested public assistance.
- Through experience rating of UI taxes, the program provides incentives for employers to stabilize employment (Duggan, Johnston, and Guo 2022).
- UI is intended to act as an automatic macroeconomic stabilizer. The program helps maintain purchasing power through increased spending from UI benefits during recessions and reduced spending during expansions (USDOL 1955).

Benefits and Duration

- Regular state-provided UI benefits should replace 50 percent of prior earnings up to the state maximum weekly benefit amount, or WBA (NCUC 1980; ACUC 1996). This percentage of earnings replacement balances adequate income support against work disincentives.
- The state maximum WBA should be indexed to two-thirds of the average weekly wages (AWW) of UI-covered workers in the state during the prior year (USDOL 1962; ACUC 1996).
- The state minimum WBA should be indexed as a percentage (e.g., 15 percent) of the AWW. The minimum may replace more than 50 percent of prior earnings for beneficiaries with minimum qualifying prior earnings.
- Some states provide dependents' allowances as an optional UI program feature under federal law. Dependents' allowances are not a compulsory feature under UI as social

insurance, but a dozen states provide them. Currently, half of those states have neglected their dependents' allowances for decades. For states offering them, dependents' allowances could be set as a percentage of an indexed state minimum WBA.

- Potential duration of regular state benefits should be a standardized 26 weeks for all beneficiaries, to provide sufficient time for job matching of skills to suitable employment opportunities (USDOL 1962; ACUC 1996). Sufficient time for active job search supports the efficient use of human resources in the economy.
- UI benefits should not be subject to federal or state income taxes. Benefits are generally low, and taxing them further reduces the adequacy of income replacement. Requiring taxation also increases the financing burden on employers and workers to provide adequate benefits (ACUC 1996).
- Receipt of private and public pension income by eligible claimants should not reduce UI benefit amounts. Eliminating such reductions improves benefit adequacy and promotes labor force attachment of older workers, who possess valuable skills required by some employers (NCUC 1980).
- A federally funded study group should be instituted to explore how to expand UI coverage to workers in the freelance economy not currently eligible under state laws for unemployment benefits. Such a study likely would include alternatives not falling under social insurance.

Extended Benefit Programs

- There should be two types of programs for emergency extensions of benefit duration. Both should be financed from general revenues of the federal government. They are 1) a permanent extended benefits (EB) program activated by triggers based on the level of the state total unemployment rate as measured by the Bureau of Labor Statistics, and 2) occasional emergency programs enacted at the discretion of Congress in crisis periods.

Financing

- Regular state UI benefits should be financed largely by experience-rated employer taxes. Experience-rated tax rates must include a minimum rate no lower than 0.1 percent and a maximum rate at least as high as required by FUTA. Between the minimum and maximum tax rates, there should be multiple rates that vary directly with an employer's benefit-charge experience. As a result, zero minimum UI tax rates for employers should be eliminated. No insurance program built on risk-based pricing should be premium free, including social insurance programs (NCUC 1980).
- States should impose a surtax on employers who are at the maximum state tax rate for three consecutive years.
- States should levy some UI tax contributions on workers.[9] Current state employee UI taxes are all less than one-half of one percent, ranging from 0.008 (in Pennsylvania, when state UI reserves are negative) to 0.425 percent (New Jersey). Workers sharing UI benefit financing with employers will give labor a stronger voice in state UI policy making.[10] New Jersey, which has the highest employee contribution rate, also has the highest UI recipiency rate. Workers in New Jersey probably have a greater sense that UI is social insurance, not welfare, because they see small UI tax withholdings on their pay stubs.

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[9] Workers already indirectly pay much of the UI tax bill nominally paid by employers. Anderson and Meyer (2000) estimate that the industry-average component of employer UI taxes is shifted to workers through wages that are lower than what workers would be paid in the absence of the UI program.

[10] For example, a 0.3 percent employee tax on a taxable wage base of $16,000 would cost $48 per year, or less than one dollar per week.

- Reserves of state accounts in the Unemployment Trust Fund (UTF) at the U.S. Treasury should be sufficient to pay benefits in an average recession in that state. Specifically, reserves should equal or exceed an average high-cost multiple (AHCM) of 1.0.[11]
- Annual appropriations for administration of UI and the ES under the Wagner-Peyser Act should be restored and maintained in real terms at the Fiscal Year/Program Year 1984 levels. This funding level could be achieved if UI and ES administrative grants to states were increased by 10 percent per year for the next five years in excess of annual rates of inflation.
- Federal UI taxes (FUTA) currently finance UI administration (federal and state) and employment services (under the Wagner-Peyser Act), crisis loans to states, and the permanent extended benefits program. The annual tax rate of 0.6 percent (a 90 percent reduction from 6.0 percent after the full federal credit) is paid on a taxable wage base of only $7,000, which has been held at the same amount since 1983. The taxable wage base is regressive and insufficient to fund adequate weekly benefit amounts. A higher wage base would expand revenues without lifting tax rates. It would shift the tax distribution more evenhandedly to the wage ranges of workers who receive benefits (Bivens et al. 2021, p. 35; Duggan, Guo, and Johnston 2022). The taxable wage base should be raised and indexed to the yearly wage growth in covered employment in the most recently measurable year. [12] The federal taxable wage base also sets the minimum for state taxable wage bases.

[11] The ACHM is the number of years benefits could be paid from existing state UI reserves at the average rate of the three highest UI payment years in the past 20.

[12] Increasing the wage base in a gradual way, similar to Social Security's Old-Age**,** Survivors, and Disability Insurance (OASDI) 1972 benefit and financing reforms, is preferable on the basis of political feasibility and equity (Ball 1972).

- Worker classification: States should apply the ABC worker classification test for purposes of determining whether UI tax contributions are required on compensation paid to workers.[13]

Access to UI

- Application systems should be easy to use and accurate. There should be at least three ways to file initial claims for benefits: 1) in person, 2) by phone, and 3) online. One-on-one, in-person help to file UI applications and respond to inquiries should be available at American Job Centers (AJCs), through call centers, and by live chat.
- Monetary-eligibility requirements should be a low dollar amount in the high quarter and 1.5 times the high quarter in the base period. An alternative (more recent) base period should be available. Qualification by hours worked in the base period should also be acceptable in all states.
- Part-time workers who are eligible for UI benefits should be able to limit work search to only part-time jobs without jeopardizing initial and continued UI eligibility. Job separation for compelling personal or family reasons should not be the basis for disqualification from UI benefits.

Program Administration

- Employees who administer UI and ES programs should be hired, promoted, and compensated based upon merit-system personnel standards to ensure professional, equitable, and impartial delivery of services.

[13] The ABC test determines whether a worker is an employee or an independent contractor.

- Control of UI and ES administration should remain at the state level under the authority of governors to support state economic development efforts. The UI and ES programs should not be subject to the authority of local workforce development boards.
- Federal UI conformity penalties should be refined to strengthen the levers of federal oversight. Under current federal UI law in Title III of the Social Security Act, failure to comply with federal requirements only allows the U.S. Department of Labor (USDOL) to withhold 100 percent of administrative grant funds for substantial noncompliance. Rather than this, USDOL should be authorized in federal law to withhold some portion of administrative grant funds to states for failure by states to exercise proper administration or to take corrective actions. USDOL also should have the authority to waive such penalties, dependent on circumstances (Horsford 2022).
- UI has always operated as a federal-state program, funded through employer taxes paid to federal and state governments and administered by states. Federalization of UI would completely change program administration. The logistics and feasibility of moving to a fully federalized UI system or of having states combine their UI programs with other states should be studied.

Reemployment of UI Recipients

- Permanently separated UI claimants should be provided with staff-assisted counseling, job search assistance, job matching, and referral to suitable job openings. States should update and use Worker Profiling and Reemployment Services (WPRS) models and systems.
- Funding for WPRS and Reemployment Services and Eligibility Assessments (RESEA) should be expanded. Because of past budget constraints, many claimants have not been

referred to reemployment services. Claimants who choose to not participate when directed should be subject to denial of benefits (Smith 2011).

- All states should administer RESEA programs through funding provided by USDOL. States receiving RESEA grants should continue to be required to annually evaluate the effectiveness of the program and services.

Special UI Programs

- All state UI laws should have programs for short-time compensation (STC) (a.k.a. "work sharing" or "shared work")[14] and self-employment assistance (SEA). States should also offer targeted reemployment bonuses to job seekers and incentives to employers to use STC instead of layoffs. During economic crises, the federal government should reimburse states for STC benefit payments to increase employer STC participation and stabilize employment. In crises, the federal government could also reimburse employers for the cost of health insurance while workers are on STC. Where adopted by states, all three programs—short-time compensation, self-employment assistance, and reemployment bonuses—should be evaluated at least every five years for effectiveness.

CONCLUSION

Only through a balanced and practical approach to reform that addresses access, benefits, financing, and public administration can the venerable Unemployment Insurance (UI) program restore the nationwide confidence of employers, workers, and the public. The list of reform

[14] As well, USDOL should conduct a research demonstration and evaluation in states that offer incentives for employer participation in STC programs through reimbursement of the costs of some employee fringe benefits during STC periods. The evaluation findings may help guide future STC policy or lawmaking.

measures offered in this paper is based on widely accepted standards for UI benefits and financing. The authors recognize that achievement of these reform measures may be instituted incrementally. In practical terms, some measures could be initiated, for example, by modest increases in state weekly benefit maximums and taxable wage bases, which, if indexed to wage growth, could set state UI programs on a pathway to client-centered and financially stable systems.[15] Additionally, a small employee UI payroll tax would demonstrate to the public that workers were sharing the tax burden with employers, resulting in workers having a stronger voice in policy deliberations.

Americans have an economic stake in producing a federal UI legislative reform package that will succeed. Should the 118th Congress take up the belated legislative task of UI reform, it will require statecraft by lawmakers who choose to rise above ideologies and parties to forge legislative compromises. They should keep in mind the words of Thomas Jefferson (Founders Online 2022), when writing to George Mason about the imperative of compromise: “In general I think it necessary to give as well as take in a government like ours.”

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[15] This incremental approach would be similar to the 1972 Social Security Reforms, which increased the taxable wage base for 1972 and 1973 and required the maximum to be indexed to wage growth thereafter. The reforms also raised the maximum benefit amount for 1972, 1973, and 1974 and required the maximum to be indexed to wage growth thereafter (Ball 1973). Furthermore, Lachowska, Vroman, and Woodbury (2020) show that indexed state taxable wage bases reduce regressivity of financing and improve state reserve adequacy.

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