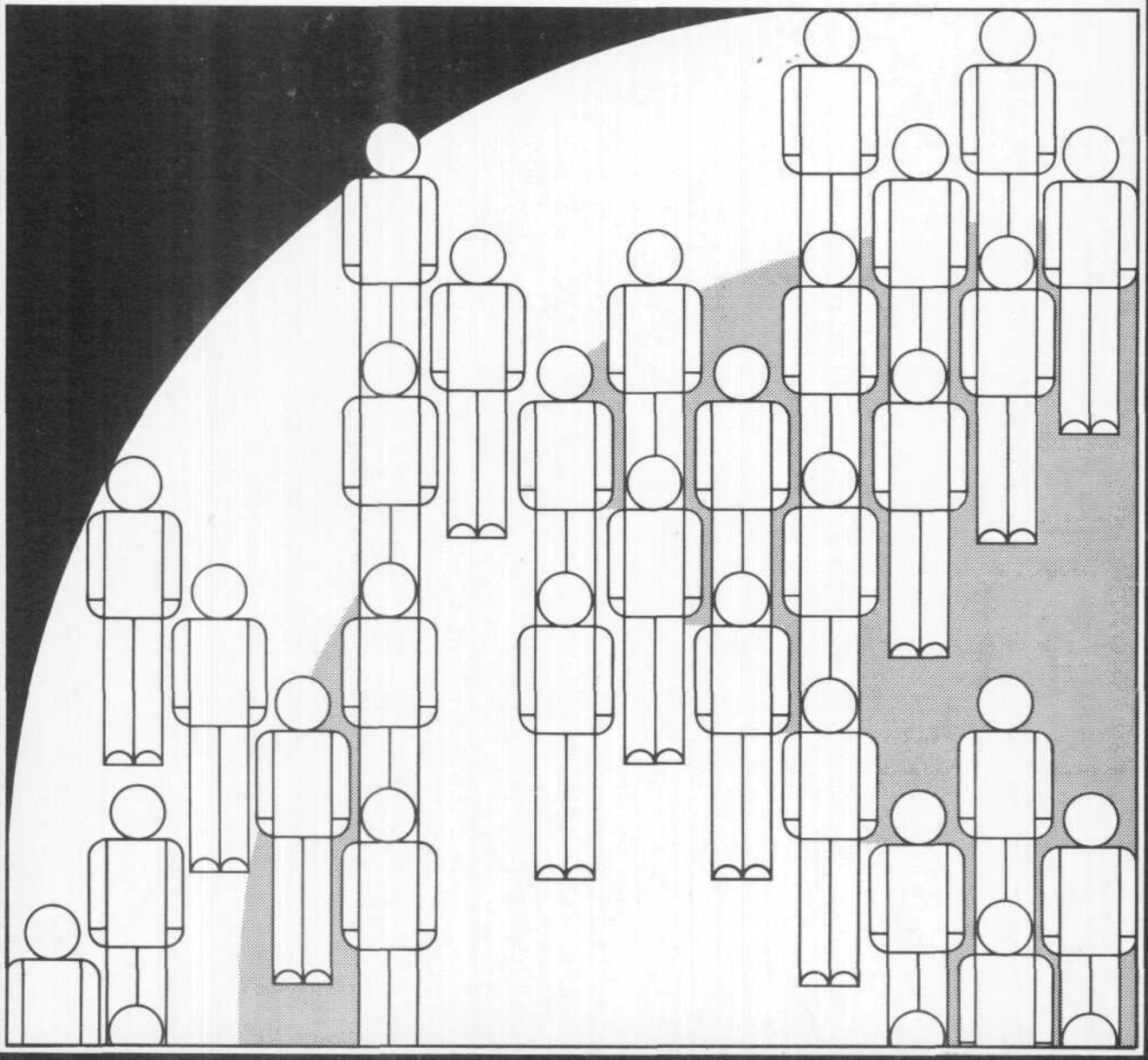
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

MARCH 1985

Promoting Employment and Maintaining Incomes with Unemployment Insurance



CBO STUDY

PROMOTING EMPLOYMENT AND MAINTAINING INCOMES WITH UNEMPLOYMENT INSURANCE

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are calendar years.

Details in the text and tables of this report may not add to totals because of rounding.

PREFACE

Although the economy has expanded significantly in recent years, unemployment still remains a concern. Legislative interest in Unemployment Insurance (UI) has focused on questions of program efficiency and the appropriate role for this program in assisting future jobless workers. This paper, prepared at the request of Senator Lawton M. Chiles, Ranking Minority Member on the Senate Budget Committee, analyzes the distribution of benefits and costs in the UI system today and considers issues affecting the future direction of the program. Options that address these issues also are examined. In accordance with CBO's mandate to provide objective and impartial analysis, this paper contains no recommendations.

This study was written by Bruce Vavrichek of the Congressional Budget Office's Human Resources and Community Development Division, under the direction of Nancy M. Gordon and Martin D. Levine. Many persons provided valuable contributions, including Richard Hendrix, Richard Kasten, Linda Radey, Alan Cohen, Janet Holtzblatt, Michael Miller, Ronald Wilus, Virginia Chupp, James Van Erden, Wayne Vroman, and Richard A. Hobbie. Patricia H. Johnston edited the manuscript. Ronald Moore typed the several drafts and prepared the paper for publication.

Rudolph G. Penner
Director

March 1985

CONTENTS

SUMMARY

Concern in the Congress has grown in recent years about how well the Unemployment Insurance (UI) system is accomplishing its goals, and what the program's role should be in helping future jobless workers. Unemployment Insurance--which replaces part of the lost earnings of involuntarily unemployed workers with funds from employer payroll taxes--has been criticized by some for making unemployment too attractive to certain workers and firms, while it is blamed by others for restricting aid to too few persons. UI also has been criticized for not actively promoting the reemployment of recipients. Specifically, some question whether experienced jobless workers might need more employment and training assistance in coming years than in the past, and whether this aid might best be provided by, or linked with, the UI program.

UI BENEFITS, TAXES, AND THEIR INCENTIVES

The UI system today consists of a complex array of benefit and tax provisions that incorporates several different incentives for workers and firms. Regular state benefits provide the major share of UI aid, but they are supplemented during periods of high unemployment by Extended Benefits (EB). A further extension of assistance--Federal Supplemental Compensation (FSC)--has been available since 1982, but is scheduled to expire at the end of March 1985. State and federal payroll taxes on employers are the main sources of program funds, with most receipts flowing from the state payroll tax.

Recipients of UI Benefits

In recent years, about one-third of all unemployed persons received regular Unemployment Insurance benefits. Eligibility for aid is restricted to jobless persons who have at least a minimum amount of recent work experience and who become unemployed for reasons such as layoffs or plant closings.

Compared with all unemployed persons, UI recipients are, on average, older, more likely to be men and to be white, and less likely to be in families

that also receive welfare benefits (see Summary Table 1). In 1983 the average UI recipient was 37 years old, compared with 33 years for all jobless persons. About two-thirds of UI recipients were men, slightly more than the share of all unemployed persons, and 21 percent lived in families receiving at least one form of welfare aid, compared with 26 percent for all unemployed. Twelve percent of UI recipients were nonwhite, compared with 17 percent of all jobless persons. Reflecting characteristics of both the workers and the jobs, a larger share of unemployed workers in goods-producing industries, such as manufacturing and mining, received UI aid than in service industries.

The average amount and duration of UI benefits received by workers differ significantly across states (see Summary Table 2). Weekly benefits

SUMMARY TABLE 1. CHARACTERISTICS OF ALL UNEMPLOYED PERSONS AND THOSE RECEIVING UNEMPLOYMENT INSURANCE BENEFITS, CALENDAR YEAR 1983

Characteristic	All Unemployed Persons	UI Recipients
Average Age (in years)	33	37
Percent Male	58	65
Percent Nonwhite	17	12
Percent in Households Receiving Welfare [a]	26	21
Percent Formerly Employed in [b]		
Goods-producing industries	42	56
Service-producing industries	58	44

SOURCE: Congressional Budget Office tabulations of the March 1984 Current Population Survey.

a. Includes food stamps, housing assistance, free or reduced-price lunches, Aid to Families with Dependent Children, and Medicaid.

b. Includes only those persons reporting former employment.

depend on wage levels in the state, the distribution of joblessness across industries and occupations, and state UI laws. For fiscal year 1984 these benefits averaged $119 nationally and state averages ranged from $101 to $143 in the examples listed in Summary Table 2. The actual duration of regular benefits, on the other hand, depends more on local economic conditions, such as the unemployment rate, and the reason why workers became unemployed, in addition to state UI laws. Regular aid lasted an average of 15 weeks nationally and ranged from about 12 weeks to 19 weeks in the examples given here.

Benefits also vary significantly among individual recipients within a state. Weekly benefits in a typical state range roughly from $30 to $175, although there is considerable variation among states in these limits. Actual durations of aid range up to 26 weeks in most states.

SUMMARY TABLE 2. UI PROGRAM STATISTICS, UNEMPLOYMENT RATES, AND AVERAGE WAGES FOR SELECTED LARGE STATES, FISCAL YEAR 1984

State	Regular UI Benefits: Average Weekly Benefit (in dollars)	Regular UI Benefits: Average Actual Duration of Aid (in weeks)	Average Weekly Wage (in dollars)	Unemployment Rate (in percents)
California	109	16.7	370	8.1
Florida	101	12.2	300	6.7
Illinois	134	18.6	365	9.4
Michigan	143	12.5	382	11.6
New York	116	19.0	384	7.4
Texas	135	15.0	351	6.3
National Average	119	15.0	338	7.8

SOURCE: Congressional Budget Office, based on data from U.S. Department of Labor, Unemployment Insurance Service; and *Employment and Earnings*, various volumes.

Although the purpose of UI aid is to help workers maintain their incomes while unemployed, the availability of this cash assistance also increases unemployment because UI benefits reduce the cost to workers of being unemployed. In addition, the availability of UI benefits encourages employers to lay off valuable workers temporarily. Because these workers receive UI aid, they do not have to take other jobs quickly, thus raising the chances that their firms can reemploy them when needed. On the other hand, UI benefits allow workers to take additional time to search for jobs that better match their interests and qualifications, which could lead to lower future jobless rates and increased productivity.

UI Taxes on Employers

The UI payroll taxes, which finance benefits, also differ across states and among employers within a state, providing incentives for firms to modify their employment policies. Combined annual federal and state UI tax liabilities per employee were estimated to range from a low of about $110 in Arizona and Texas in 1983 to over $300 in Illinois, Pennsylvania, Rhode Island, West Virginia, and Wyoming, and $600 in Alaska. The average federal tax was about $55 per worker, while state tax liabilities averaged about $165.

One of the major sources of tax variation among employers is the "experience rating" of state payroll taxes--under which an employer's tax rate depends on the benefits received by workers it formerly laid off or terminated. This feature makes firms more accountable for the joblessness they create and acts to stabilize employment. Not all state UI tax payments are experience rated, however, and many firms still pay either considerably more or considerably less than the share of benefit costs they generate. About 60 percent of tax liabilities were found to be subject to variable tax rates in a sample of states in 1981. Firms in seasonal industries, including construction and agriculture, paid less in taxes than their workers received in benefits, while employers in service industries--especially wholesale trade and finance, insurance, and real estate--paid more in taxes than their workers received in aid. Federal UI taxes are not experience rated, and are uniform across employers in a state.

Unemployment Insurance taxes can influence the behavior of firms in several ways. The presence of these taxes raises the cost of labor and can reduce the demand for its services. In addition, two specific features of UI taxes provide incentives for firms to adjust their employment policies. First, experience rating affects the layoff and hiring decisions of firms in several ways by tying the cost of jobless benefits to the worker's former employer. Second, the low taxable wage base in UI--$7,000 for the federal base--imparts a bias against employing low-wage or part-time workers

because the UI tax represents a larger fraction of their wages than it does for higher-wage employees. This small tax base does provide an incentive for firms to reduce labor turnover, however.

ISSUES AND OPTIONS

Although major changes in federal UI laws have occurred infrequently during the program's nearly fifty years of existence, many persons today find the arguments in favor of some changes to be persuasive, and have developed specific proposals. Legislative and policy interest in Unemployment Insurance have focused on three issues:

- Could the program's incentives for workers and employers be changed to reduce unemployment without seriously restricting the income support role of UI?
- Should the program be modified during future periods of high joblessness to provide more or different aid to long-term unemployed persons?
- Should UI funds be used more aggressively to promote the reemployment of program recipients?

Changing Program Incentives for Workers and Firms

Despite some program features to the contrary, Unemployment Insurance increases unemployment. The availability of benefits and incomplete experience rating of UI taxes both act to raise joblessness. Options to reduce unemployment include modifying the program's work incentives for employees and reallocating UI costs among firms.

Changes Affecting Workers. Although few have argued that the amount of UI aid now provided to each eligible jobless worker is excessive, reducing the work disincentives of the program would require limiting assistance. Thus, options to reduce joblessness in this way focus on restricting the conditions under which aid is available and increasing the efficiency of recipients' efforts to find jobs.

Requiring UI recipients in all states to wait two weeks before initially receiving aid--instead of the one-week delay common in most states today--would increase the initial cost of joblessness for many workers and could lower unemployment as well as UI outlays. This change would encourage faster and more intensive job search--possibly while workers still are employed--to avoid the initial period without benefits. Although it would not reduce the potential amount of aid available to workers, this option

would reduce the actual duration of benefits for workers who return to work before exhausting all available aid. If implemented in fiscal year 1987--allowing time for states to make changes in their UI laws--this change could reduce UI outlays, and the federal budget deficit, by about $900 million in that year.

More rigorous enforcement of eligibility rules, such as the one requiring UI beneficiaries to search actively for work while receiving aid, could induce some recipients to increase their efforts to find jobs as well as reduce unwarranted benefit payments. On the other hand, such strict enforcement has the potential to intimidate or harass program recipients, and some persons fear it could deter certain eligible workers from applying for aid. Results of a small-scale pilot program by the Department of Labor indicated that benefit overpayments represented about 14 percent of total aid in that sample, and resulted primarily from the failure of recipients to seek work. Instituting a quality control program nationwide in fiscal year 1986 would cost about $30 million, although the reduction in benefit outlays that might result has not yet been estimated accurately.

Finally, requiring UI recipients who are not on temporary layoff to take a one- or two-day seminar in job-search techniques could better equip them to look for work. In good economic times, this aid could potentially shorten their period of unemployment by roughly two to three weeks, on average. When economic times are bad, however, even well-prepared job-seekers might not benefit appreciably from this aid. In addition, if the workers' skills are not in demand, job-search assistance alone would do little to promote reemployment, no matter what the condition of the labor market. Providing limited job-search instruction to one-third of all UI recipients in fiscal year 1986 at a cost of $150 per worker would cost about $400 million in that year.

Alterations Affecting Firms. More closely linking payroll tax rates to employers' unemployment experiences could also reduce joblessness. One way to increase the sensitivity of firms' UI tax liabilities to their employment policies would be to widen the range of experience-rated state tax rates. Increasing the maximum tax rate would raise costs for some firms that are now undercharged, while decreasing the minimum tax rate would lower costs for firms with stable employment. This change could place added burdens on firms struggling to stay in business, however, and might lead to reductions in employment in some industries and regions. If a federal mandate in this area were desired, it might specify that a certain minimum share of UI costs--perhaps 50 percent to 70 percent--be effectively experience rated in each state.

Another alternative would be to charge firms for a larger share of UI costs during the early weeks of a spell of unemployment, while making them less liable for later weeks of aid. Proponents of this change maintain that, although experience rating might be desirable for temporary layoffs, it is not necessarily so for permanent layoffs since it discourages new hiring and desirable layoffs (such as those caused by structural change in the industry). On the other hand, some persons oppose charging firms different amounts for different weeks of aid because UI benefit costs are the same for each week of aid. Specific features of this proposal would determine whether it raised, lowered, or left unchanged program revenues.

Increasing the federal UI taxable wage base--which also acts as the minimum base for state UI taxes--would also change the distribution of UI costs among firms, but little can be said in general about the overall effect on employment. This change would make the UI tax more progressive, however, because it would concentrate most of the tax increase on the wages of workers earning more than the current lower tax base. Indexing the federal UI wage base to average wages in the economy--as is done with the Social Security tax base--would increase combined federal and state UI revenues by about $850 million in fiscal year 1988, the first full year that this change probably could be implemented.

Extending UI During Periods of High Unemployment

The desirability of extending UI aid during periods of high unemployment is debated in the Congress with each major rise in the jobless rate. If UI is viewed primarily as an insurance program for workers, then the rationale for cyclical increases in aid might be limited because insurance benefits usually do not change with need. If UI is seen at least in part as welfare, however, then added merit might be found in tying benefit amounts to the degree of hardship. Assuming the Congress wished to provide such aid to long-term jobless workers, questions also would arise about whether UI is the proper vehicle to deliver this support and, if so, how this plan could be implemented.

The Byrd-Heinz Proposal. A proposal that has formed a starting point in the 99th Congress for discussions on extending cash assistance was introduced in 1983 by Senators Byrd, Heinz, and others. This proposal would extend UI cash grants for up to 35 weeks beyond the 26 weeks of regular aid available in most states, with the precise duration depending on state and national jobless rates. Resources to pay for these added benefits would be provided equally from state and federal UI funds when jobless rates are relatively low, but would turn increasingly to federal UI funds and federal general revenues when unemployment rises. The estimated cost of this proposal for fiscal years 1986 through 1990 is about $900 million.

Loans For Jobless Workers. Instead of extending the duration of cash grants to long-term unemployed persons, others have proposed providing loans that would be repayable after the workers became reemployed. The interest rate charged on these loans could be a market rate, or it could be lower if subsidies were desired. Proponents of this alternative maintain that loans would satisfy the temporary financial needs of long-term jobless workers, and would do so at a much lower cost to the federal government than grants. Loans also would reduce the work disincentives provided by the availability of long-term cash grants. Moderate and low-income persons might have difficulty repaying these loans even after becoming reemployed, however, because they might not have enough income both to live on and to repay this debt. If $2,000 in subsidized loans had been provided to 10 percent of the persons exhausting regular UI benefits in calendar year 1983, about $800 million would have been lent at a total federal cost of about $100 million to $150 million.

Using UI to Provide Reemployment Assistance

Some persons have proposed using the UI system more broadly to provide reemployment aid to jobless workers--either directly by using UI funds to assist workers in becoming reemployed, or indirectly by using the UI program as a vehicle to provide other retraining funds.

Allow UI Funds to be Used for Retraining and Relocation. Allowing UI funds to be used for retraining and relocation would permit workers more flexibility in planning strategies to return to work. Unemployed persons whose skills are not in demand might use UI funds to finance training in a new skill, while workers whose skills are needed in other regions of the country might use a lump-sum UI payment to relocate. Training costs per worker could be about $2,500 in fiscal year 1986, while relocation aid might be less than $1,000. A recent Administration proposal to allow up to 2 percent of state UI funds to be used for training would permit states to allocate up to about $370 million in 1986 for this purpose.

Use UI Funds for Reemployment Vouchers. Alternatively, long-term UI recipients could be permitted to transfer part of their remaining benefit entitlement to vouchers payable to new employers that hire them. This aid would reduce the cost to firms of employing these workers and might aid these UI recipients in becoming reemployed. By restricting vouchers to long-term jobless, this option would probably have little added federal cost since most of these workers would otherwise remain unemployed and collect benefits. On the other hand, jobs for assisted workers could come at the expense of other workers, so the net impact on employment and on UI costs would be uncertain.

Create Individual Training Accounts. UI also could be used as a vehicle for collecting other funds for worker retraining, for example, Individual Training Accounts financed through payroll taxes. Under a typical plan, workers and firms would each contribute to the worker's account. These payments would accumulate, with interest, until the worker used them for retraining or retired--at which time they would be returned to the worker and employer. Opponents of this broad-based retraining fund maintain that the need for retraining on this large scale has not been established, and that it would be a needless diversion of private funds. In addition, they point out that such a tax would increase the cost of labor, and could contribute to inflation and reduced employment. Under the plan specified in Chapter V, the average annual contribution for the worker and firm would be about $120, with about $25 billion to $30 billion in training funds being collected in the first year.

CHAPTER I

INTRODUCTION

Unemployment Insurance (UI) benefits replace part of the lost earnings of involuntarily unemployed persons and are financed primarily by state and federal payroll taxes on employers. Aid is usually available for up to 26 weeks under regular state programs, with the size of weekly benefits determined by the recipient's prior employment and wages and by state UI laws. Benefits also are available for subsequent weeks of joblessness through the Extended Benefit (EB) and Federal Supplemental Compensation (FSC) programs, but these are limited by program and economic conditions. Funds for regular benefits come from state UI taxes, while EB is financed equally with state and federal UI tax revenues, and FSC benefits are paid out of federal general revenues. 1/

Today, concern with UI focuses on how well the program is accomplishing its goals, and whether the conventions and practices currently used in the program need to be modified for the future. The balancing of potentially opposing objectives in several areas of UI has spurred criticism both from those who feel the program provides strong incentives for workers and firms that increase unemployment, and from those who feel it is too restrictive and should do more to further the reemployment prospects of program recipients. This report analyzes the functioning of the Unemployment Insurance system today and examines these concerns and possible solutions for the future.

GOALS AND PRINCIPLES OF THE UI SYSTEM

The design of the Unemployment Insurance system reflects three basic goals. 2/ The most important objective is to alleviate temporarily the

1. For an analysis of the financial structure of the UI system and options to promote its viability, see Congressional Budget Office, *Unemployment Insurance: Financial Condition and Options for Change* (June 1983).

2. For an historical perspective on the UI system, see William Haber and Merrill G. Murray, *Unemployment Insurance in the American Economy* (Homewood, Illinois: Richard D. Irwin, Inc., 1966).

hardship that results from the loss of wage income during unemployment. Although the causes of joblessness vary over time--including cyclical and seasonal variations in output levels and structural and technological shifts in the economy--the Unemployment Insurance system continues to focus on this goal. Second, UI helps to stabilize the overall level of economic activity by providing cash to jobless workers. Program outlays increase with rises in unemployment, thereby providing funds to offset reductions in consumer spending that otherwise would occur. Finally, UI encourages individual employers to stabilize their employment by varying their tax rates based on the unemployment they create.

Insurance principles have guided development of the program during its nearly fifty years of existence, although some program aspects are based on welfare considerations. The main distinction between UI and welfare programs is that UI aid is provided without regard to the economic condition of the recipient. The absence of a needs test places UI in a class with Social Security as major government programs providing nonmeans-tested assistance to persons.

UI departs from private insurance, however, in several ways. The program compensates a higher percentage of the wage loss for low-wage earners than high-wage workers, for example, because of limitations on weekly benefit levels. In addition, the amount of UI aid varies in proportion to previous employment or earnings, rather than being fully available from the moment premiums begin to be paid on the worker's behalf. Finally, some states provide dependents' allowances that vary benefit amounts with family size.

In addition to these principles, several conventions have developed in UI that affect the way the program aids the unemployed. Program eligibility and benefits, for instance, are based on the employment experiences of workers within a recent one-year period. This convention disregards the longer-term work histories of workers such as those who have intermittent but long-standing labor force attachments, and those who have worked for long periods in the past but who--for reasons such as dislocation from their prior careers--have had little or no employment in the last year.

Another convention in UI is that, for any particular worker, the potential duration of regular benefits is fixed, and does not depend on labor market conditions. Extensions of aid are sometimes provided in response to cyclical rises in joblessness, but periods of persistent high or low unemployment do not result automatically in longer or shorter potential durations of regular aid.

Many program conventions are the result of compromises between conflicting objectives or principles. Benefit levels, for example, need to be set high enough to provide adequate support, but not so high that workers would want to become unemployed just to receive them. Similarly, program eligibility is based on the insurance nature of UI, but some concessions to need are included in benefit payments.

THE FEDERAL/STATE UI SYSTEM

One consequence of the difficult task of translating program objectives into specific rules applicable in various local labor markets is the division of responsibilities in UI between federal and state governments. The federal role consists of maintaining the overall structure of the UI program, setting some specific requirements for state programs, and providing certain types of aid. The federal Unemployment Trust Fund (UTF) in the U.S. Treasury is used to collect state and federal UI payroll tax receipts and to disburse funds for benefits and administrative costs. In addition to mandating that states use this federal trust fund for their UI programs, the federal government also requires under certain specific conditions that states pay or do not pay benefits to jobless workers, and that state payroll tax systems have certain basic features. 3/ Aid provided by the federal government includes benefits for long-term jobless persons and administrative funding for both state and federal UI programs.

Compliance of state programs with federal rules is ensured because the federal government reduces the federal UI tax for employers in states with federally approved UI programs. Without this approval, that tax would be about $430 for a typical worker, compared with $56 with federal approval. 4/ Loss of federal approval would also deprive states of federal funding for their UI and Employment Security, or "job service," agencies.

---

3. Major federal requirements for state UI programs are: all state payroll tax revenues must be deposited in the UTF; all money withdrawn from these trust fund accounts must be used to pay benefits, except under certain limited conditions; reduced state UI taxes on employers must be permitted only on the basis of the employer's past experience with UI benefits; nonprofit organizations and governmental entities must be permitted to finance benefit costs by reimbursing the trust fund, instead of paying taxes; and compensation must not be denied to persons who refuse to accept work if the job is vacant because of a labor dispute, or if, as a condition of being employed, the individual would be required to join--or not to join--a union, or if the conditions of work are substantially less favorable than those in similar work in the locality.

4. These calculations apply to workers whose earnings at least equal the federal tax base of $7,000 and who work in states that receive the full federal tax reduction (see Chapter III). In addition, to ensure that employers receive the maximum federal tax reduction, state UI programs must have tax bases at least as large as the federal one.

Within the constraints of federal law, states are responsible for developing UI benefit and tax structures that meet the needs of workers and employers within their boundaries. State UI provisions establish eligibility requirements, determine the duration and amount of regular UI benefits, and specify state payroll taxes. Because of the differing needs of workers and firms in various states, considerable variation exists across states in their UI programs. All 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands operate UI programs under federal guidelines. 5/

As a result of the joint federal/state nature of UI, both federal and state tax receipts and benefits appear as revenues and outlays in the unified federal budget. Thus, all UI activities affect the federal budget deficit in the same manner.

5. In this study, the term "state" refers to any of these 53 jurisdictions. The federal government also operates special national programs for former military, federal civilian, and railroad workers. These programs are organized differently from the main UI programs, however, and are not included in this report.

CHAPTER II

WHO RECEIVES UI BENEFITS?

Unemployment Insurance benefits are available to experienced workers who have recently lost their jobs. Only workers unemployed for economic reasons--those who have been laid off or whose jobs have been terminated because of a plant closing, for example--usually are eligible for aid. To qualify for benefits, jobless workers must also have earned at least a minimum amount of wages or worked for at least a certain minimum time, or both, within a recent one-year period. Once eligible, recipients must actively seek work, and must remain able to work and available for work to continue receiving UI benefits.

Three levels of UI aid currently are available. Regular state programs provide the largest share of total UI benefits--an estimated $14.2 billion of the projected total aid of $15.3 billion in fiscal year 1985--and are also used to determine eligibility and benefits in the other two programs. Regular benefits are available to jobless persons for up to 26 weeks in most states. Extended Benefits are the second level of aid, providing workers who exhaust regular UI with up to 13 weeks of added benefits when the unemployment rate in their state exceeds a certain level. These benefits have been largely eliminated in recent years by changes in federal law raising the unemployment thresholds necessary to activate the program, and by broader economic and program changes that have further reduced the likelihood that these benefits would become available. 1/ The third level of benefits, Federal Supplemental Compensation, provides up to between 8 and 14 weeks of additional benefits to jobless persons after they exhaust regular and, if available, extended benefits. This temporary program was first implemented in September 1982 and is scheduled to expire at the end of March 1985.

1. Increases in the unemployment thresholds necessary to initiate this aid were made as part of the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). Current CBO forecasts project that only a few states will have unemployment rates high enough to provide EB during each of the next few years.

44-477 O -85 - 3

Along with the duration of benefits, the weekly benefit level determines the amount of UI aid available to each jobless worker. Weekly benefits are set by state laws and depend on the worker's employment history. Benefit amounts vary widely both within states for different workers and across states for similar workers.

This chapter analyzes the demographic and economic characteristics of UI recipients, describes state differences in benefits, and considers some measures of program adequacy. It also examines the work disincentives created by this aid and assesses some of the program's effects on the labor market.

CHARACTERISTICS OF UI RECIPIENTS

Of the 26 million persons unemployed at some time in calendar year 1983, only 10.1 million--or about 39 percent--received UI benefits. 2/ Many jobless persons are not eligible for aid either because they became unemployed voluntarily or because they do not have sufficient recent work experience. Of the four groups of jobless persons identified in labor force surveys--persons who lost their last job, persons who voluntarily left their last job, new entrants, and reentrants into the labor force--job losers are most likely to qualify for aid. 3/ Even so, in recent years the number of job losers has exceeded significantly the number of UI recipients.

---

2. For purposes of comparing all unemployed persons with UI recipients, the category "unemployed" is defined to include persons classified by the Bureau of Labor Statistics (BLS) as unemployed as well as any other persons receiving UI benefits. These counts are taken from the Current Population Survey--a household-based survey used by the BLS to estimate employment and unemployment.

3. Persons who quit their last job usually are not considered to be involuntarily unemployed and generally are not eligible for aid. New entrants into the labor market generally do not have the requisite earnings histories to qualify for aid. The same is often true of reentrants into the work force, although they may qualify for benefits if they were employed during about the last year.

   The share of all unemployed in each category varies considerably over the business cycle. In 1983--a time of high unemployment and, thus, a period when a relatively high fraction of unemployed had lost their jobs--job losers accounted for 58.4 percent of all unemployed, while job leavers, new entrants, and reentrants accounted for 7.7 percent, 22.5 percent, and 11.3 percent, respectively.

Comparisons of Unemployed Persons and UI Recipients

Because UI recipients include mostly experienced workers rather than other groups of unemployed persons, they are on average older and more likely to be men than are jobless persons generally (see Table 1). In calendar year 1983 unemployed persons aged 16-24 represented only 15 percent of UI recipients, but comprised almost 33 percent of all unemployed. Persons aged 25-54, on the other hand, represented over 72 percent of UI recipients, but accounted for only about 59 percent of all the jobless. Nearly two-thirds of UI recipients in 1983 were men, compared with about 58 percent of all unemployed workers.

While the education levels of the two groups were broadly similar, UI recipients were more homogeneous in terms of income than were jobless workers generally, and included a smaller share of nonwhite workers. About 67 percent of UI beneficiaries had family incomes between $10,000 and $40,000 in 1983 compared with about 57 percent of all jobless. Significantly fewer UI recipients had family incomes under $10,000 than did all unemployed persons. About 12 percent of UI recipients were nonwhite, compared with approximately 17 percent of all jobless persons.

A smaller share of UI recipients received welfare benefits in the year they were unemployed than did jobless persons generally, probably for several reasons. Some UI beneficiaries presumably owned assets accumulated during former years of work that disqualified them from many types of welfare aid. In addition, because UI benefits are counted as income in determining eligibility for most welfare programs, few UI beneficiaries could qualify for that aid while receiving UI. As a result, a smaller share of UI recipients lived in households receiving food stamps, housing assistance, and free or reduced-price school lunches than did unemployed persons generally. In addition, less than half the fraction of UI recipients received Aid to Families with Dependent Children (AFDC) and Medicaid than did all unemployed persons. Finally, although data are only now becoming available on the simultaneous receipt of these benefits, it is likely that an even smaller proportion of UI recipients received welfare assistance at the same time they received UI. 4/

4. Data are now becoming available from the Survey of Income and Program Participation that will allow for a more complete investigation of this issue. See, for example, Bureau of the Census, "Economic Characteristics of Households in the United States: Third Quarter 1983," Current Population Reports, Series P-70, No. 1 (September 1984).

TABLE 1. CHARACTERISTICS OF UNEMPLOYED PERSONS AND UI RECIPIENTS, CALENDAR YEAR 1983 (In percents)

Group	Distribution of All Unemployed Persons a/	Distribution of UI Recipients	Percent of Unemployed Receiving UI Benefits
Total	100	100	39.0
Age			
16-24	32.7	15.0	17.8
25-54	58.9	72.3	47.8
55 and over	8.4	12.7	58.7
Gender			
Male	58.2	64.5	43.2
Female	41.8	35.5	33.1
Race			
White	82.6	87.6	41.3
Nonwhite	17.4	12.4	27.9
Education			
Less than H.S. Degree	29.5	26.0	34.3
H.S. Degree	44.5	49.7	43.5
At least some college	26.0	24.3	36.5
Annual Family Income			
Less than $10,000	29.0	19.2	25.8
$10,000 - $19,999	26.4	29.9	44.1
$20,000 - $39,999	31.0	37.4	47.0
$40,000 or more	13.5	13.4	38.6
Welfare Recipiency			
Food stamps	16.5	12.4	29.2
Housing assistance	3.8	2.1	21.4
Reduced-price lunch	14.0	12.0	33.4
AFDC b/	4.3	1.6	14.3
Medicaid	9.6	4.6	18.5

SOURCE: CBO tabulations of the March 1984 Current Population Survey.

a. Includes persons unemployed or receiving UI benefits at some time in 1983.
b. Aid to Families with Dependent Children.

Reflecting both characteristics of the persons and the jobs, UI recipients more often worked in mining and manufacturing industries and less often in service industries than did unemployed persons generally (see Table 2). About 67 percent of unemployed persons in mining received UI benefits in 1983, along with 64 percent of jobless workers in durable manufacturing industries and almost 59 percent in nondurable manufacturing. Less than 35 percent of the unemployed received UI in most service industries, including retail trade, business and repair services, and professional services, among others.

Recent Declines in the Share of Unemployed Receiving UI Benefits

Since about 1980, the share of jobless workers receiving UI benefits has declined dramatically. 5/ This shift, which is still not well understood, is often depicted as a divergence between two jobless rates, the insured unemployment rate (IUR)--the ratio of regular UI recipients to workers in covered employment--and the total unemployment rate (TUR)--the well-known ratio of all active job seekers to the civilian labor force. As seen in Figure 1, the gap between these two series gradually widened in the 1970s, but has increased markedly since about mid-1980. 6/ This gap also is reflected in the decline in the percent of unemployed receiving UI benefits (see Figure 2). Research indicates that this drop has been associated with an unexpected decline in the number of UI recipients relative to the number of unemployed job losers (see Figure 3). By 1983 the difference in the size of these two groups had risen from nearly zero to well over two million persons.

The growing difference between the IUR and TUR before 1980 probably was related to easily identifiable factors. First, adult women and young workers comprised an increasing share of both the employed and unemployed populations. These groups tended on average to have less strong attachments to the work force than did older men and often did not have the requisite work histories to qualify for UI benefits. Second, during that period, there was a shift in the industrial composition of employment from goods-producing industries such as manufacturing--in which output is more variable and many workers have characteristics that enable them to qualify

5. This section draws on unpublished work by Joseph Hight at the U.S. Department of Labor and on Gary Burtless and Daniel H. Saks, "The Decline in Insured Unemployment During the 1980s" (The Brookings Institution, Brookings Discussion Papers in Economics, March 1984).

6. Although most public policy debates on this issue involve comparisons of the IUR and TUR, the analysis does not differ qualitatively if the number of UI recipients is compared with the total number of jobless persons.

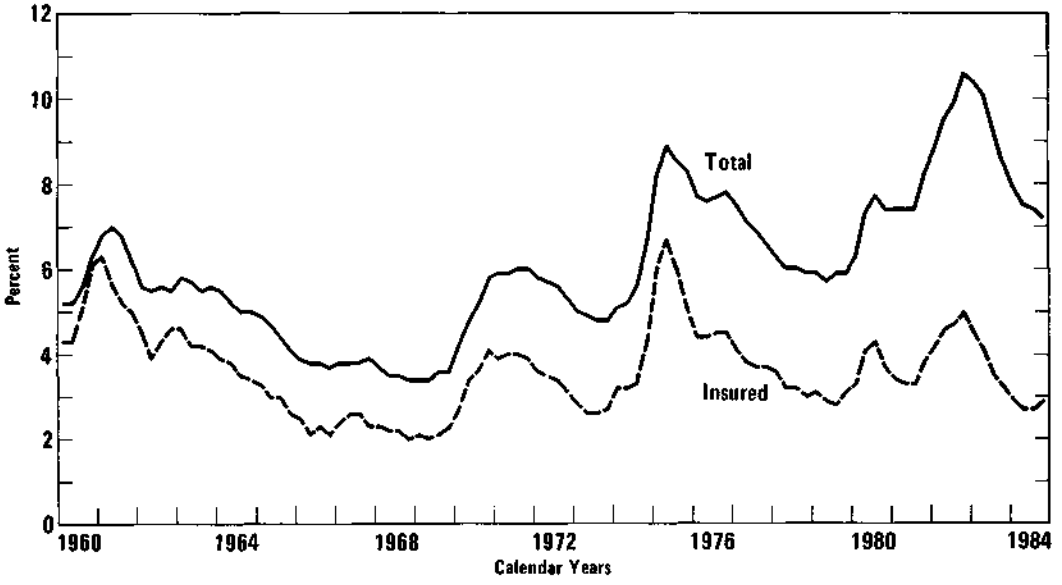
TABLE 2. UNEMPLOYED PERSONS AND UI RECIPIENTS, BY INDUSTRY, CALENDAR YEAR 1983 (In percents)

Industry of Longest Job in 1983	Distribution of All Unemployed Persons a/	Distribution of UI Recipients	Percent of Unemployed Receiving UI Benefits
Total	100	100	39.0
Agriculture	3.2	3.0	35.9
Mining	1.1	1.9	67.3
Construction	11.1	14.6	51.3
Manufacturing			
Durables	11.3	18.6	64.0
Nondurables	8.2	12.3	58.7
Transportation	4.4	5.5	48.6
Wholesale Trade	2.7	3.0	43.5
Retail Trade	16.6	11.3	26.5
Finance	2.8	2.9	39.6
Business and Repair Services	4.8	4.1	33.4
Personal Service and Entertainment	5.2	3.2	24.1
Professional Service	9.8	7.8	30.7
Public Administration	2.2	2.0	36.1
No Industry Reported	16.5	9.7	22.9

SOURCE: CBO tabulations of the March 1984 Current Population Survey.

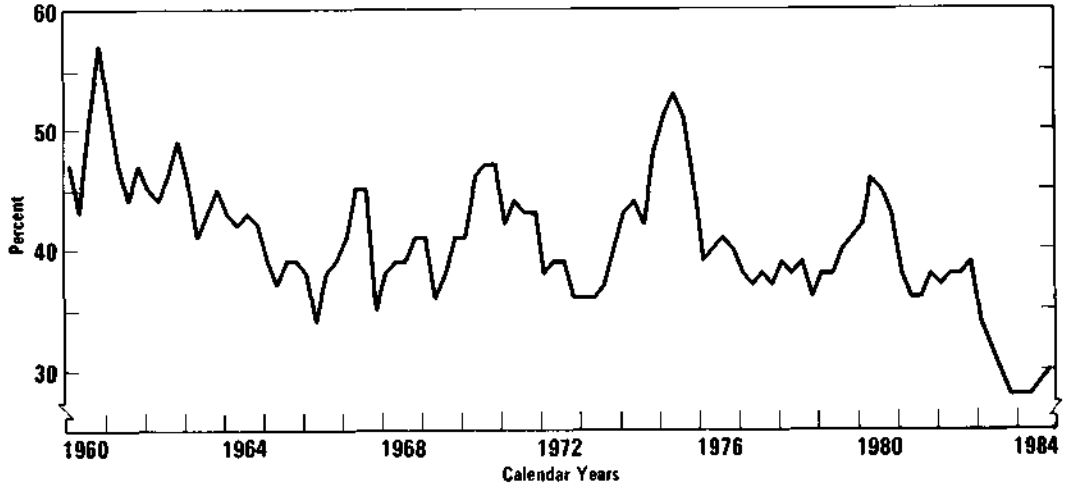
a. Includes persons unemployed or receiving UI benefits at some time in 1983.

Figure 1.
Comparison of Total and Insured Unemployment Rates (Seasonally Adjusted)



SOURCES: Congressional Budget Office, based on data from Department of Labor, Bureau of Labor Statistics; Department of Commerce, Bureau of Economic Analysis.
NOTE: Total unemployment rate is the rate for civilian workers.

Figure 2.
Percent of Unemployed Receiving Regular UI Benefits (Seasonally Adjusted)

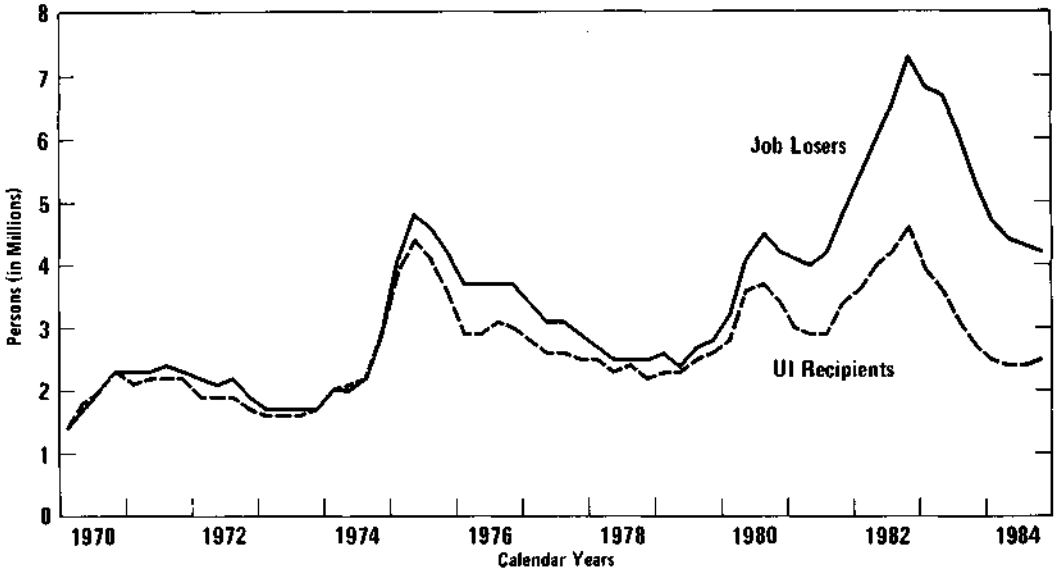


SOURCES: Congressional Budget Office, based on data from *Economic Report of the President*, various years; Department of Labor, Bureau of Labor Statistics.

for UI benefits--to service industries--in which significantly fewer workers typically receive aid. Finally, UI coverage was extended during the 1970s to groups of service workers who were relatively unlikely to receive UI benefits when unemployed, causing a further divergence between these two unemployment rates.

The main causes of the decline in the share of unemployed receiving UI benefits since 1980 are not so easily established, however. Changes over time in the age-sex composition of the unemployed, the industrial origin of recent job losers, and the regional distribution of unemployment are not nearly sufficient to explain this change. The possibility that the back-to-back recessions of 1980 and 1981-1982 caused workers to have insufficient employment histories to qualify for benefits likewise is not supported by UI program data on eligibility and benefit determinations. Finally, although changes were made in the UI program in the early 1980s as part of overall budgetary restraint, modifications were made mostly in the Extended Benefit program and did not affect regular UI. In any case, these changes were not of a sufficient magnitude to cause shifts in program participation as large as those that have occurred since 1980.

Figure 3.
Job Losers and UI Recipients (Seasonally Adjusted)



SOURCES: Congressional Budget Office, based on data from *Economic Report of the President*, various years; Department of Labor, Bureau of Labor Statistics.

One remaining explanation is that a series of relatively small legislative and administrative changes at both the state and federal levels have combined to reduce the number of UI recipients. This apparent result might have been caused both by deterring applications for aid by raising and more strictly enforcing eligibility standards and by reducing the net benefits available to potential claimants. 7/ Specific changes include: tightening administrative controls, such as more vigorous enforcement of state work-search requirements while receiving benefits; tightening state disqualification provisions for quitting a job or being fired for misconduct; taxing part of UI benefits; reducing UI benefits for persons receiving Social Security or private pensions; and imposing a one-week waiting period before receiving benefits. Some of these changes in state programs were in response to changes in federal laws or administrative practices, but many others probably resulted from a desire to improve program administration and reduce state UI outlays.

It is important to note that, while the data are broadly consistent with this explanation of the reduction in the share of jobless receiving aid, they do not provide a confirmation of that view. Indeed, the explanation most consistent with the data is that a large number of unemployed job losers who are eligible for aid simply are not applying for UI benefits, although this, in turn, would be difficult to explain.

DIFFERENCES IN UI BENEFITS AMONG STATES

The actual benefits received by workers depend on the provisions of state laws and on the previous work histories of the recipients. Because of the diversity in both factors, individuals across the nation often receive very different benefit amounts.

Differences in benefits attributable to state UI laws can be isolated by comparing benefits for the same kind of worker in different states (see Table 3). Four hypothetical workers, each with one nonworking dependent, are considered in this example, and their benefits calculated in six large states. The first worker was formerly employed full time (40 hours per week, 52 weeks per year) at the federal minimum wage of $3.35 per hour. The second person also worked full time but at $8.00 per hour, about equal to the average U.S. wage in 1984. The third worker was employed full time at $15.00 per hour, and the fourth hypothetical worker was employed part time (20 hours per week, 52 weeks per year) at $5.00 per hour. Because

7. See Burtless and Saks, "The Decline in Insured Unemployment During the 1980s," p. 2.

of the full-year nature of their previous work, all four hypothetical workers in this example were eligible for the full 26 weeks of benefits in the states considered. 8/

Benefits differ very little among states for the lower-wage workers in these examples, while a large source of variation for higher-wage workers is the state maximum benefit level. 9/ Both the minimum-wage worker and

TABLE 3. WEEKLY UI BENEFITS FOR HYPOTHETICAL WORKERS IN SELECTED STATES, CALENDAR YEAR 1984 (In dollars)

	Prior Hourly Wage and Employment Status			
	Full Time a/			Part Time b/
State	$3.35 c/	$8.00 d/	$15.00	$5.00
California	68	128	166	53
Florida	67	150	150	50
Illinois	74	176	184	55
Ohio	67	160	223	50
New York	67	160	180	50
Texas	70	167	189	52

SOURCE: Commerce Clearing House, *Unemployment Insurance Reports*, various volumes.

NOTE: Hypothetical workers are each assumed to have one nonworking dependent.

a. Full time is defined as 40 hours per week and 52 weeks per year.
b. Part time is defined as 20 hours per week and 52 weeks per year.
c. $3.35 per hour is the federal minimum wage.
d. $8.00 per hour is about the same as the average private nonagricultural wage in 1984 of $8.33.

8. The potential duration of benefits would vary more among states for other types of workers, however.

9. These comparisons do not take into account other features of state UI laws that influence the relative ease with which jobless workers can qualify, and remain qualified, for aid, however.

the part-time worker are eligible for about one-half of their former weekly wage in most of the states considered. More variation exists for the worker who formerly earned $8 per hour; benefits range from $128, or 40 percent of the worker's former weekly wage, in California to $176, or 55 percent of the former wage, in Illinois. At $15.00 per hour, the hypothetical worker is eligible for the maximum benefit in all states considered; benefits range from $150 to $223 in the states considered, and replace between 25 percent and 37 percent of former wages.

When individuals in varying economic circumstances are considered in combination with different state laws, significant variations are also found in average benefits and average durations of aid (see Table 4). For fiscal year 1984, when the national average benefit was about $119 per week, average recipients in most states received between $90 and $140. 10/ With the national average duration of regular benefits at 15 weeks in that year, average durations ranged from 8.7 weeks in Virginia to 19.7 weeks in the District of Columbia.

MEASURES OF PROGRAM ADEQUACY

Although determining the adequacy of UI benefits is difficult and necessarily arbitrary, certain program characteristics do provide some information on the economic circumstances of program recipients. The benefit exhaustion rate--that is, the percent of recipients who use up all available aid--is one potential measure of the appropriateness of the duration of aid, although it does not provide information about the adequacy of weekly benefit levels. The wage replacement rate--that is, the fraction of a beneficiary's former wage that is replaced by UI--compares the recipient's benefit level to former earnings. Because of the lack of an objective standard to measure adequacy, however, neither of these indicators can be used to conclude whether or not UI benefits are sufficient.

The Benefit Exhaustion Rate

The fraction of UI recipients who use all available regular UI aid is a highly cyclical program indicator, reflecting at least in part the relative difficulty

10. For individual recipients in various states, weekly benefits ranged from a low of between $5 and $62 to a high of between $84 and $294.

TABLE 4. AVERAGE WEEKLY BENEFIT PAYMENT AND DURATION OF AID FOR REGULAR UI, BY STATE, FISCAL YEAR 1984
(In dollars and in weeks of aid)

State	Average Weekly Benefit Amount	Average Actual Duration of Regular Benefits
Total	119	15.0
Alabama	91	11.2
Alaska	134	14.9
Arizona	100	14.4
Arkansas	91	12.4
California	109	16.7
Colorado	144	13.2
Connecticut	127	12.2
Delaware	106	12.6
District of Columbia	140	19.7
Florida	101	12.2
Georgia	97	9.3
Hawaii	130	14.7
Idaho	112	12.8
Illinois	134	18.6
Indiana	90	13.0
Iowa	124	13.5
Kansas	126	13.5
Kentucky	96	15.2
Louisiana	149	18.7
Maine	103	17.0
Maryland	121	14.5
Massachusetts	123	15.4
Michigan	143	12.5
Minnesota	141	14.6
Mississippi	86	14.1
Missouri	88	11.9

(Continued)

TABLE 4. (Continued)

State	Average Weekly Benefit Amount	Average Actual Duration of Regular Benefits
Montana	123	13.8
Nebraska	98	12.8
Nevada	122	14.2
New Hampshire	105	9.0
New Jersey	124	16.4
New Mexico	110	17.1
New York	116	19.0
North Carolina	97	8.9
North Dakota	137	14.9
Ohio	137	15.6
Oklahoma	131	13.5
Oregon	122	15.0
Pennsylvania	132	17.5
Puerto Rico	63	a/
Rhode Island	111	14.3
South Carolina	90	10.1
South Dakota	104	10.9
Tennessee	85	12.6
Texas	135	15.0
Utah	129	12.6
Vermont	107	14.1
Virgin Islands	103	17.6
Virginia	105	8.7
Washington	131	16.9
West Virginia	121	18.5
Wisconsin	131	14.6
Wyoming	120	15.3

SOURCE: U.S. Department of Labor, Unemployment Insurance Service.

a. Not available.

of finding jobs in different phases of the business cycle. 11/ The exhaustion rate for regular UI during the last decade has ranged between 26 percent in July 1979 and about 41 percent in July 1983.

This ratio often varies across states even more than over time. In 1982, for instance, when the overall exhaustion rate for regular UI was about 39 percent, the average rate in states ranged from less than 10 percent to nearly 60 percent. A large part of this variation is related to the distribution of maximum potential durations within states, however. For example, of the ten states with the highest exhaustion rates in 1982, seven had below-average maximum potential benefit durations; conversely, of the ten states with the lowest exhaustion rates, eight had above-average maximum benefit durations.

Another potentially useful indicator of the appropriateness of the duration of UI payments would be what UI recipients do after exhausting benefits; unfortunately, very little information exists in this area. Claimants who exhaust benefits either remain in the labor force as unemployed job seekers, find employment, or drop out of the labor force. If UI recipients find employment quickly after exhausting benefits--or if they simply drop out of the labor force--then a case could probably be made that, in these instances, UI benefits were not productive either because the worker could have returned to work sooner or because the worker did not intend to return to work at all. On the other hand, if most exhaustees remain unemployed and searching for work, then the adequacy of UI benefits might be called into question. 12/

---

11. Benefit exhaustion rates reported in the regular UI program and used here are only rough approximations of the true rates. While the number of exhaustions are measured properly as the number of so-called final payments, the fraction of recipients who exhaust benefits is inaccurate because it uses these exhaustions as a share of new recipients about six months earlier. This method is imprecise for several reasons, among them that many recipients are not eligible for six months of benefits--about one-third were eligible for less than that amount in the year ending in September 1984--and that many recipients do not have uninterrupted spells of joblessness during the benefit period. The magnitude of this error is not known, however. Exhaustion rates for program extensions such as EB and FSC generally are not used as measures of program adequacy because that aid is available only in periods of high unemployment.

12. For an analysis of the behavior of persons who exhausted UI benefits in the 1960s, see Stephen T. Marston, "The Impact of Unemployment Insurance on Job Search," Brookings Papers on Economic Activity, 1: 1975, pp. 37-40. For information on persons who exhausted benefit extensions during the mid-1970s, see Mathematica Policy Research, Inc., "Follow-Up Study of Recipients of Federal Supplemental Benefits," September 25, 1978. The nature of the job taken by a formerly unemployed worker would also be important in assessing the adequacy of UI aid.

The UI Wage Replacement Rate

State laws generally set the nominal wage replacement rate for weekly UI benefits at about 50 percent of a worker's former gross wages, but several factors affect the actual share of wages that are replaced. First, states generally place relatively low upper limits on weekly benefits, so that workers who are otherwise eligible for larger benefits receive less than the gross wage replacement rate of 50 percent. The average weekly benefit in calendar year 1983 was only about 37 percent of average weekly wages, for example, and about 38 percent of UI beneficiaries were eligible for the maximum weekly benefit in that year. 13/ Second, workers who become unemployed also lose fringe benefits, such as health insurance and pension contributions, which are not replaced by UI. Finally, if the entire spell of unemployment is considered in calculating the wage replacement rate, then that rate is further reduced by two factors: for those who do not exhaust benefits, the one-week waiting period before benefits are available in most states reduces total aid by the weekly benefit amount; for those who exhaust benefits, aid is generally received for only the first part of their period of unemployment.

On the other hand, the share of wages that are replaced by UI is also increased by several factors. Unlike wages and salaries, much of UI benefits is not taxed. 14/ This increases the after-tax replacement rate of UI, because jobless workers retain a larger share of the UI benefits than they do of wages. Also, because certain costs associated with working, such as transportation and special clothing, need not be paid while a worker is unemployed, a larger fraction of income can be used for living expenses by jobless workers. This might be offset somewhat by the costs associated with searching for another job, however.

Based on empirical analyses to date, the average net wage replacement rate is probably between 45 percent and 50 percent, indicating that

---

13. The average weekly benefit refers to workers who become unemployed and receive UI, while the average wage refers to all covered workers. Because UI recipients may not be typical of all workers, however, the average wage of all workers is not necessarily the appropriate wage to compare with UI benefits for purposes of determining wage replacement rates. See Martin Feldstein, "Unemployment Compensation: Adverse Incentives and Distributional Anomalies," *National Tax Journal*, 27:2 (June 1974), p. 232.

14. UI benefits are subject to tax for single persons with incomes in excess of $12,000 and for couples with incomes above $18,000. According to data from federal income tax returns for 1982 and 1983, about 36 percent of the UI benefits reported in those years were included in adjustable gross income and, thus, were subject to tax. In addition, workers do not pay Social Security taxes on UI benefits, which also increases the net wage replacement rate for those benefits.

the factors that reduce the replacement rate from the original 50 percent probably somewhat outweigh those factors that increase it. 15/ This tentative conclusion is based on a wide range of estimates from a variety of studies of the many factors influencing the replacement rate. 16/ Substantial variation in the net replacement rate was also found among the states. One study estimated the average wage replacement rate in 1980 at about 46 percent, for example, but reported state replacement rates ranging from 26 percent to 61 percent. 17/

WORK DISINCENTIVES OF UI BENEFITS

The availability of jobless benefits for workers increases both the real and the measured levels of unemployment. 18/ Actual reductions in employment and increases in unemployment occur for two main reasons. First, UI benefits reduce the cost to workers of being unemployed, making it more likely they will become unemployed and, once unemployed, more likely they will remain so longer. 19/ Second, the availability of UI benefits makes employers more willing to lay off valuable workers for short periods of time because they are less likely to lose them to other firms. This source of increased joblessness occurs because UI benefits provide workers with a temporary source of income that limits their need to look for other jobs quickly. UI increases measured unemployment by prompting jobless persons who might otherwise leave the labor force to remain and collect benefits.

---

15. For comparisons of various studies, see Daniel S. Hamermesh, *Jobless Pay and the Economy* (Baltimore: The Johns Hopkins University Press, 1977), p. 21; and Wayne Vroman, *Employment Termination Benefits in the U.S. Economy* (Washington, D.C.: Employee Benefit Research Institute, 1983), pp. 50-64.

16. The studies considered differ because they use different definitions of the replacement rate, and because they were based on different time periods and geographical areas. Also, these studies were done before UI benefits were subject to tax. The conclusion from these studies was that the net replacement was just over 50 percent. Taking account of the taxation of part of UI benefits reduces the net replacement rate.

17. See Wayne Vroman, "State Replacement Rates in 1980," in National Commission on Unemployment Compensation, *Unemployment Compensation: Studies and Research*, vol. 1 (1980), pp. 165-186.

18. For a discussion of the effects of UI on firms, see Chapter III.

19. For instance, the availability of UI benefits could make workers less willing to accept wage reductions, job changes, or reduced hours of work, which could lead to more occurrences of unemployment.

Increases in unemployment by some workers are not necessarily bad if they result in better matches between those workers and new jobs. This outcome--which has not been accurately isolated in empirical research to date--could occur if the workers use the financial resources provided by UI to search more selectively for jobs that match their interests and qualifications. This might not only increase their future productivity but also could lower their future joblessness.

The effects of UI on joblessness have been found to depend in large part on the overall tightness of the labor market. When unemployment is low, and jobs are relatively easy to obtain, higher weekly wage replacement rates for UI provide a significant disincentive to work, while increases in the maximum duration of these benefits have much smaller effects. When unemployment is high, however, the size of the wage replacement rate probably has a smaller effect on unemployment: employed persons are unlikely to leave hard-to-find jobs to receive temporary UI benefits, and unemployed persons find jobs difficult to obtain with or without jobless benefits. The maximum duration of aid could be more important in these times, however.

Considerable empirical evidence supports the conclusion that higher wage replacement rates induce longer spells of insured unemployment when unemployment is low. 20/ A midpoint of the range of estimates calculated in several high quality studies is that a 10 percentage point increase in the gross wage replacement rate of UI--raising the ratio of weekly benefits to weekly wages from 45 percent to 55 percent, for instance--increases the duration of UI benefits by about one-half week when unemployment rates are relatively low. 21/ For example, the average duration of UI benefits might be increased from 13 weeks to 13.5 weeks if wage replacement rates were increased by 10 percentage points. This effect is thought to be much smaller when jobless rates are high and workers have fewer opportunities to secure jobs.

Overall, the effects of regular UI on the behavior of workers have been estimated to increase the unemployment rate in the economy by roughly 10 percent to 15 percent in periods of low unemployment and by

---

20. Increases in the potential duration of UI benefits have also been found to increase the average duration of insured unemployment, although the apparent magnitude of this effect is smaller and the estimates are less precise.

21. See, for example, Hamermesh, *Jobless Pay and the Economy*, p. 37, and Vroman, *Employment Termination Benefits*, pp. 127-128.

44-477 O -85 - 4

about 5 percent when joblessness is high. 22/ For example, if the unemployment rate corresponding to a relatively tight labor market were 6 percent, then without the effects of UI on workers that rate might have been between about 5.2 and 5.5 percent. A cyclically high jobless rate of 9.5 percent might have been approximately 9 percent without the availability of UI benefits.

These estimates are not precise, however, and should only be taken as indications of the order of magnitude of the program's effects on workers and the unemployment rate. Also, they do not take into account possible reductions in future unemployment or increases in post-unemployment earnings that could occur if workers find more stable or higher paying new jobs as a result of UI-financed increases in job search. Finally, for the most part, these estimates do not include the effects of the UI program on the behavior of firms.

22. These estimates are based on Hamermesh, op. cit., pp. 47-55, but are updated somewhat to reflect more recent program and labor market conditions.

CHAPTER III

WHO PAYS UI TAXES?

State and federal Unemployment Insurance payroll taxes provide most of the program revenues (see Table 5). These taxes are paid by employers based on the wages of their employees and on the benefits received by their former workers. 1/ State UI taxes now account for about two-thirds of total revenues--$19.6 billion of the $28.8 billion intake in fiscal year 1985--while federal UI taxes contribute an additional 20 percent of inflows--about $5.7 billion in 1985.

Revenues from federal and state general funds, which had increased in recent years as a result of unusually high unemployment, are expected to continue to decline in future years. Federal general funds are used to pay interest on program reserves; to fund the temporary Federal Supplemental Compensation program; and, indirectly, to subsidize noninterest-bearing program loans from the U.S. Treasury. Transfers from state general funds are used to pay interest on federal loans to states. Total funding of UI from federal and state general revenues is projected to decline from $5.5 billion in fiscal year 1984 to $2.2 billion in fiscal year 1986.

This chapter analyzes features of the UI tax system and the potential incentives it provides to employers. 2/ The first section presents the basic provisions of federal and state UI taxes. The second section describes in more detail the variations in state taxes among employers based on so-called "experience rating" systems, which tie tax rates to a firm's previous use of program funds. The last two sections analyze who actually pays UI taxes and the potential incentives they create for firms.

---

1. Four states--Alabama, Alaska, New Jersey, and Pennsylvania--sometimes require employee contributions to their state UI programs.

2. Transfers to the UI program from state and federal general funds are not described further in this chapter because, although often controversial, they generally deal with financial management rather than operation of the program.

TABLE 5. SOURCES OF UNEMPLOYMENT INSURANCE REVENUES, FISCAL YEARS 1984, 1985, AND 1986
(In millions of dollars)

Revenue Source	1984	1985	1986
Employers a/			
State payroll tax	19,040	19,610	18,280
Federal payroll tax b/	5,920	5,700	6,750
Federal General Revenue			
Interest payments on program reserves	780	1,200	1,510
Program subsidies c/			
Federal Supplemental Compensation	2,980	1,010	0
Not charging interest on certain UI loans d/	1,140	850	540
State General Revenue e/	550	410	190
Total Revenues	30,410	28,780	27,270

SOURCES: Congressional Budget Office estimates and Department of Labor, Unemployment Insurance Service, *UI Outlook* (February 4, 1985).

a. See text for a discussion of the extent to which employers ultimately pay the UI taxes.

b. In addition to usual federal tax receipts, this category includes added federal taxes in certain states used to repay delinquent state loans. For fiscal year 1984 this added tax was $900 million, while for fiscal years 1985 and 1986 these added taxes are projected to be $1,180 million and $2,130 million, respectively.

c. Does not include possible federal subsidy stemming from below-market interest rates provided on loans to states or possible federal gain from the payment of below-market interest on state reserves.

d. Estimated by CBO based on noninterest-bearing loans from the federal general fund.

e. Consists of the payment of interest on federal loans to states.

STATE AND FEDERAL UI PAYROLL TAXES

The provisions of UI payroll taxes are set in both federal and state law. The federal tax would generate the largest amount of revenue if it were not for the tax reduction given to employers in states with federally approved UI programs. 3/ As a result of this reduction, the major portion of UI tax revenues comes from state payroll taxes.

In calendar year 1984, about 90 million persons worked in jobs covered by UI, representing about 86 percent of all employed persons and over 95 percent of all nonagricultural wage and salary workers. Jobs not covered by this program include self-employment and certain agricultural and domestic work. Employees in nonprofit organizations and state and local governments are covered by the UI program, but their employers are not required to pay taxes in advance; instead, they can reimburse the program for the benefits actually received by their former workers.

UI taxes per employee differ significantly among the states because of differences in both federal and state taxes (see Table 6). In 1983 estimated total taxes per worker ranged from about $110 in Arizona and Texas to about $350 in Wyoming and $600 in Alaska. The national average was about $220 per worker. Of these total taxes, the average federal tax per employee was about $55 and the average state tax was about $165. The structures of federal and state UI payroll taxes and the reasons for these differences among states are described next.

The Federal Tax

Parameters of the net federal UI tax are the same for all firms in a given state. In most states, the tax is 0.8 percent of the first $7,000 in covered wages per employee. Effective as of January 1985, this net tax rate is the difference between a gross rate of 6.2 percent and a tax reduction of up to 5.4 percent given by the federal government to employers in states with federally approved programs. 4/ As mentioned earlier, it is the value of this 5.4 percent reduction that gives the federal government implicit power to control the basic tax and benefit structures of state UI programs.

All employers in a state must pay a higher federal tax, however, if the state program has a delinquent federal UI loan. States that have not repaid

3. All states have federally approved UI programs.

4. Before 1985 the net tax rate was also 0.8 percent, but the gross rate was 3.5 percent and the tax reduction was 2.7 percent.

TABLE 6. ESTIMATED FEDERAL AND STATE UI TAX LIABILITIES PER WORKER, BY STATE, CALENDAR YEAR 1983 (In dollars)

State	Estimated Federal and State UI Taxes Per Worker	State	Estimated Federal and State UI Taxes Per Worker
Alabama	240	Montana	210
Alaska	600	Nebraska	130
Arizona	110	Nevada	250
Arkansas	250	New Hampshire	130
California	220	New Jersey	290
Colorado	140	New Mexico	170
Connecticut	220	New York	250
Delaware	290	North Carolina	140
Florida	120	North Dakota	290
Georgia	130	Ohio	270
Hawaii	260	Oklahoma	140
Idaho	240	Oregon	270
Illinois	330	Pennsylvania	340
Indiana	200	Rhode Island	340
Iowa	220	South Carolina	150
Kansas	230	South Dakota	130
Kentucky	230	Tennessee	220
Louisiana	250	Texas	110
Maine	220	Utah	280
Maryland	150	Vermont	220
Massachusetts	250	Virginia	160
Michigan	260	Washington	290
Minnesota	220	West Virginia	330
Mississippi	160	Wisconsin	200
Missouri	200	Wyoming	350

SOURCE: Congressional Budget Office estimates based on unpublished UI financial data from the Department of Labor, and employment data from the March 1984 Current Population Survey.

NOTE: The national average was about $220. The federal tax liability includes increased federal taxes in states with delinquent loans. Because of inconsistencies in data, these estimates should be considered approximate. The District of Columbia, Puerto Rico, and the Virgin Islands are omitted because of data limitations.

federal loans within two to three years after they were issued have their federal tax rate increased by at least 0.3 percentage points annually, with the proceeds used to repay the principle of the loan. 5/ Several changes in repayment conditions for federal loans have been made in recent years that limit, or cap, federal tax increases if the debtor states abide by certain solvency conditions, however. 6/

Increases in the net federal tax rate on employers in states with overdue program loans are displayed in Table 7. 7/ At the beginning of calendar year 1985, 19 states had outstanding federal loans, and employers in 15 of those states were required to pay higher federal taxes because at least part of their loans were overdue. The resulting added federal tax liability for 1984 was about $1.2 billion. Four states with delinquent loans qualified for a complete cap on their tax increase for 1984 because they met various solvency conditions, and an additional seven states qualified for partial caps. These tax limitations reduced the affected states' tax liabilities by about $290 million in calendar year 1984.

State Taxes

State UI tax systems differ markedly among states, although all follow the general guidelines set out in federal law. As with the federal tax, the basic

---

5. To avoid a tax-rate increase, states must repay federal loans by November 10 of the second complete calendar year after the loan was issued. Thus, there are strong incentives to repay loans within about 22 to 34 months after they were issued. In addition to the 0.3 percentage point increase in the federal tax rate, firms can be subject to even larger increases in the tax rate if their state's loan remains overdue more than three years. See, for example, House Committee on Ways and Means, *Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means*, Committee Print 99-2 (February 22, 1985), pp. 293-298.

6. The Omnibus Budget Reconciliation Act of 1981 permitted a cap on the federal tax rate increase of 0.6 percentage points (or of the increase in effect in the preceding year) if the state met four solvency conditions. To qualify, the state must not reduce UI taxes; must not take any action to reduce the solvency of its UI program; must have an average UI tax rate that exceeds the average benefit rate during the last five years; and must have an outstanding loan balance no larger than that balance three years ago.

   The Social Security Amendments of 1983 (P.L. 98-21) allowed states not meeting the four conditions for a cap to receive a partial cap if they met selected combinations of those four conditions. See Committee on Ways and Means, *Background Material*, p. 295.

7. Employers in all states pay a tax rate of 0.8 percent, plus any penalty amount.

TABLE 7. STATE UI LOANS AND FEDERAL TAX INCREASES
(In millions of dollars)

State a/	Outstanding Loans b/ Interest Free	Outstanding Loans b/ Interest Bearing	Calendar Year 1984 Federal Tax Increases c/ Percent of Taxable Wages	Calendar Year 1984 Federal Tax Increases c/ Added Tax	Calendar Year 1984 Federal Tax Increases c/ Status of Tax Increase d/
Colorado	0	42	0	0	--
Connecticut	163	33	0.7	66	cap
District of Columbia	10	33	1.1	24	partial cap
Illinois	1,328	379	0.8	210	partial cap
Iowa	0	38	0.3	16	--
Kentucky	0	11	0	0	--
Louisiana	0	521	0.3	26	--
Michigan	1,420	246	0.7	130	partial cap
Minnesota	118	86	0.8	76	partial cap
Montana	0	9	0	0	--
New Jersey	320	0	0.6	114	cap
Ohio	810	636	0.7	163	partial cap
Pennsylvania	1,310	661	0.8	196	partial cap
Puerto Rico	36	0	0.6	17	cap
Texas	0	416	0.3	115	--
Vermont	19	0	0.6	7	cap
Virgin Islands	1	3	0.9	2	--
West Virginia	79	229	0.7	21	partial cap
Wisconsin	127	408	0	0	--
Total	5,742	3,751	--	1,183	

SOURCE: Congressional Budget Office, based on data from the Department of Labor, Unemployment Insurance Service.

a. Includes only states with outstanding UI loans.
b. As of the start of calendar year 1985. Loans issued before April 1982 are interest free, while the remaining loans accrue interest at a rate equal to the average cost of borrowing for the federal government, up to a limit of 10 percent.
c. Taxes are assessed on wages paid in 1984, but are not collected until January 1985.
d. Eight states either did not meet the requirements for a cap or did not need a cap on tax increases.

parameters of state UI taxes are the tax base--the wages of each employee subject to tax--and the tax rates.

State tax bases must be at least as large as the federal base of $7,000, and are larger in 34 states (see Table 8). Bases above the federal minimum range from $7,100 in Connecticut to $21,800 in Alaska and all wages in Puerto Rico. The average state tax base in calendar year 1985 is estimated to be $7,900. In addition, nearly all states automatically increase their tax bases if the federal base rises above theirs.

State tax rates vary among employers in a given state according to the benefits received by workers they formerly laid off or terminated. This so-called "experience rating" feature is the main difference between state and federal UI taxes, and is the reason that states can reduce their tax rates below the federal standard of 5.4 percent without losing at least part of the federal tax reduction of that amount. The average state tax rate in calendar year 1985 is projected to be about 3 percent of taxable wages, reflecting, among other things, the use of experience rating systems in nearly all states.

Tax rates also differ across states and within states over time, according to the financial condition of their UI programs. Different rate schedules typically are used, depending on the ratio of UI program reserves to annual employer payrolls. For instance, a state might apply its most favorable tax schedule--the lowest average tax rate--if those reserves exceed 5 percent of payroll, and apply its least favorable schedule--or highest average tax rate--if the reserves fell below 2 percent of payroll.

EXPERIENCE RATING

Adjusting each employer's tax rate on the basis of actual experience with unemployment is designed to make firms more accountable for the joblessness they create. 8/ This, in turn, has the goal of offsetting the tendency of UI to increase unemployment. Within a given tax schedule, tax rates on employers in a state often vary by about 5 percentage points because of experience rating--with a state having a maximum tax rate of 6 percent and a minimum rate of 1 percent, for instance.

8. Only Puerto Rico does not have an experience rating system for UI taxes.

TABLE 8. STATE UNEMPLOYMENT INSURANCE PAYROLL TAX BASES AND RATES, JANUARY 1985

State	Tax Base (in dollars)	Tax Rate On Taxable Earnings a/ (in percents)	
		Minimum	Maximum
Alabama	8,000	0.50	5.40
Alaska	21,800	1.00	6.50
Arizona	7,000	0.10	6.65
Arkansas	7,500	0	6.00
California	7,000	0.30	5.40
Colorado	8,000	0	5.40
Connecticut	7,100	0.50	6.40
Delaware	8,000	0.10	8.50
District of Columbia	8,000	0.10	5.40
Florida	7,000	0.10	6.65
Georgia	7,000	0.01	5.71
Hawaii	15,100	0	5.40
Idaho	15,000	0.10	6.80
Illinois	8,500	0.20	6.60
Indiana	7,000	0.02	4.50
Iowa	11,200	0	7.00
Kansas	8,000	.025	5.40
Kentucky	8,000	0.30	10.00
Louisiana	7,000	0.30	5.40
Maine	7,000	0.50	6.50
Maryland	7,000	0.10	8.00
Massachusetts	7,000	0.40	6.00
Michigan	9,000	0.30	6.90
Minnesota	10,300	0.10	7.50
Mississippi	7,000	0.10	6.40
Missouri	8,000	0	7.80
Montana	8,600	0.20	4.40
Nebraska	7,000	0	5.40
Nevada	11,100	0.30	4.70
New Hampshire	7,000	0.01	6.50

(Continued)

TABLE 8. (Continued)

State	Tax Base (in dollars)	Tax Rate On Taxable Earnings a/ (in percents) Minimum	Maximum
New Jersey	10,100	0.40	6.20
New Mexico	10,000	0.10	5.40
New York	7,000	0	6.40
North Carolina	8,700	0.10	5.70
North Dakota	10,700	0.50	5.00
Ohio	8,000	0	4.30
Oklahoma	7,000	0.10	5.50
Oregon	13,000	0.90	5.40
Pennsylvania	8,000	0.30	8.80
Puerto Rico	(all wages)	2.95	2.95
Rhode Island	10,600	0.80	8.40
South Carolina	7,000	0.25	5.40
South Dakota	7,000	0.10	10.50
Tennessee	7,000	0.15	10.00
Texas	7,000	0	6.00
Utah	12,100	2.25	4.50
Vermont	8,000	0.40	8.40
Virgin Islands	8,000	b/	b/
Virginia	7,000	0.10	6.20
Washington	10,000	0.50	5.40
West Virginia	8,000	0	7.50
Wisconsin	9,500	0	6.40
Wyoming	9,500	0	9.75

SOURCES: Congressional Budget Office based on Department of Labor, *Comparison of State Unemployment Insurance Laws* (January 1985).

a. Minimum rate is the lowest tax rate on the most favorable tax schedule--that used when program balances are high--and maximum rate is the highest tax rate on the least favorable schedule--that used when program balances are low.

b. Tax rates not available because the Virgin Islands is implementing its experience rating program in 1985.

Even with experience rating, however, many firms still pay either considerably more or considerably less than the share of benefit costs they generate. This occurs because firms often reach the limits of experience-rating tax ranges, because some types of benefits are not charged to specific employers, and because firms who go out of business do not continue to pay taxes. 9/

Types of Experience-Rating Plans

One of two types of experience-rating formulas is used in 47 states: the "reserve-ratio" or the "benefit-ratio" method. These formulas assign state employer tax rates based on a combination of the firm's previous tax payments, benefits paid to former workers, and taxable payroll. 10/

Reserve-Ratio Plans. The reserve-ratio method is the most popular experience-rating plan, and is currently used in 33 states. It is essentially a form of cost accounting, in which a separate account is kept for each employer. Taxes paid by the firm are credited to the account, and benefits paid to the firm's former workers are deducted. The ratio of the account balance to the employer's taxable payroll is the basis for determining the tax rate. Generally, the difference between taxes and benefits is cumulative throughout a firm's history, while payroll is an average of only the prior three years. Firms with higher ratios generally are assigned lower tax rates, and conversely.

---

9. The effectiveness of experience rating also depends on the method used to identify the employer to be charged with a specific worker's benefits. The most prevalent method, used in 32 states, levies charges in proportion to employment in the one-year base period. In addition, 12 states charge base-period employers in inverse chronological order; a limit is usually placed on the amount any one employer must pay under this method, and when that amount is exhausted, the next previous employer is charged.

10. One of two other plans is used in 5 states, while Puerto Rico charges all firms the same tax rate. The benefit-wage ratio formula used in 4 states calculates tax rates based on the ratio of "benefit wages" to total taxable wages. Benefit wages are the wages earned in the base year by employees who are later unemployed. Total benefit payments in the state are then related to benefit wages to determine a tax-rate schedule that will generate revenues sufficient to cover costs.

    The payroll variation plan measures the stability of payrolls and does not take benefits into account at all. This approach presumes that a firm's experience with unemployment will be reflected in declines in its total payroll from quarter to quarter or year to year. Generally firms whose payrolls do not decrease, or decrease only by a small amount, qualify for the lowest tax rates.

Benefit-Ratio Plans. The benefit-ratio formula used in 14 states is similar to the reserve-ratio, except that it does not take account of former UI taxes paid by a firm. Under these plans, the ratio of benefits paid to taxable payrolls determines the firm's tax rate. The theory is that, if each firm pays a tax rate that approximates its benefit rate, the program will be adequately financed. In most states, the time period during which benefits and payrolls are measured is the most recent three years, thereby limiting the extent of a firm's history that is considered for both benefits and taxable payrolls. In this sense, the benefit-ratio method is more geared to short-term experience than is the reserve-ratio method.

The Degree of Experience Rating

Departures from complete experience rating occur primarily because states do not set maximum tax rates high enough to cover the benefit costs of all employers and because states do not charge specific employers for benefits paid during certain periods of unemployment. Firms already paying the maximum tax rate frequently incur no additional tax liability, at least in the short run, when their employees receive UI benefits, implying that these benefits must be paid for by other employers. In addition, benefits charged to a "common" account rather than to specific employer accounts sometimes include those, if any, paid after periods of disqualification for voluntarily quitting, being fired for good cause, and refusing suitable work, and those paid under the Extended Benefit program. 11/ Another departure from experience rating arises from the payment of benefits to former employees of firms that no longer pay taxes--so-called "inactive" accounts. These firms might have gone out of business or moved to another state.

In 1981 these three components of ineffectively charged benefits totaled, on average, an estimated 42 percent of all benefits paid in reserve-ratio states for which data are available (see Table 9). 12/ Benefits charged to firms at maximum state tax rates are estimated to average about 26 percent of total aid. Noncharged benefits range from zero to 37 percent of total benefits in these states and average 11 percent. Finally, benefits charged to inactive accounts range between zero and 16 percent and average 5 percent.

---

11. In addition, seasonal employers in some states are charged only for benefits paid for unemployment during their season.

12. Other ineffectively charged benefits include benefits charged to firms paying the minimum tax--if those benefits do not increase taxes--and any other benefit payments that do not change a firm's tax rate. For more on ineffectively charged benefits, see National Commission on Unemployment Compensation, *Unemployment Compensation: Final Report* (July 1980), p. 87.

TABLE 9. COMPONENTS OF INEFFECTIVELY CHARGED BENEFITS FOR SELECTED RESERVE-RATIO STATES, CALENDAR YEAR 1981 (As percent of total benefits)

State a/	Estimated Benefits Charged to Firms At Maximum Tax Rate	Noncharged Benefits	Benefits Charged to Inactive Accounts	Total
Arizona	3	19	1	23
Arkansas	18	21	4	43
California	24	10	b/	34
Colorado	24	15	6	45
Georgia	4	21	7	32
Hawaii	44	1	11	56
Idaho	13	28	2	44
Indiana	16	3	5	24
Iowa	40	14	5	59
Kansas	13	37	5	55
Maine	52	12	16	80
Massachusetts	25	13	8	46
Missouri c/	22	26	b/	48
Nebraska	39	20	1	60
New Hampshire c/	28	6	b/	34
New Mexico	14	22	8	44
New York	19	2	7	28
North Carolina	13	20	8	41
North Dakota c/	60	0	5	65
Ohio	44	5	7	56
Rhode Island	20	24	11	55
South Dakota	24	13	8	45
Tennessee	18	17	16	51
West Virginia	32	14	1	47
Average d/	26	11	5	42

SOURCES: Congressional Budget Office estimates and unpublished data from the Department of Labor.

a. Includes only reserve-ratio states for which data are available. While these states are not a random sample of all states, they do not appear to be atypical in terms of other basic features of their UI programs. In 1981, these states accounted for almost half of total U.S. employment.

b Less than 0.5 percent.

c. Estimate based on data from earlier years.

d. Weighted by benefits paid in each state in 1981.

Interindustry Subsidies

Sizable financial transfers among industries occur as a result of incomplete experience rating (see Table 10). From 1976 through 1981, employers in agriculture and construction paid slightly over 50 cents in taxes for each dollar of benefits received by their workers. In the wholesale trade and finance industries, on the other hand, employers paid more than $2 in taxes for each dollar of benefits. This sizable cross-industry subsidy is also reflected in the annual subsidy per worker: the agriculture and construction industries received annual subsidies of about $150 and $240, respectively, for each worker on their payrolls, while in the wholesale trade and finance industries, the costs were $80 and $70 per worker, respectively. 13/

INCIDENCE OF THE UI PAYROLL TAX

The fact that the UI tax is collected from employers does not necessarily imply that it is ultimately paid by them. 14/ A tax on payrolls raises the cost of employing labor and introduces an incentive to economize on it. If firms respond to the tax by reducing their demand for labor, wages might fall somewhat, thus shifting part of the cost of the tax to workers in the form of lower wages. If firms respond by reducing production or by increasing prices, part of the cost of the tax might be shifted to the consuming public. The part of the tax not paid for by workers or consumers is absorbed by the firms or by their shareholders. 15/

---

13. For more on UI taxes and benefits by industry, see Joseph M. Becker, S.J., *Experience Rating in Unemployment Insurance: An Experiment in Competitive Socialism* (Baltimore: The Johns Hopkins University Press, 1972), pp. 336-337.

14. See Richard S. Toikka and Peter Greenston, "The Impact of Financing," in National Commission on Unemployment Compensation, *Unemployment Compensation: Studies and Research*, vol. 2 (July 1980), pp. 343-348.

15. If wage reductions attributable to this tax reduce the quantity of labor supplied, then some of the tax cost could be paid by other factors of production. In general, a smaller supply of labor tends to increase wages and reduce the rate of return on capital. In this way, changes in work behavior could change the allocation of the tax burden between labor and capital. See Congressional Budget Office, *Aggregate Economic Effects of Changes in Social Security Taxes*, Technical Analysis Paper (August 1978), p. 12; and Martin S. Feldstein, "The Incidence of the Social Security Payroll Tax: Comment," *American Economic Review*, 62:4 (September 1972), pp. 735-738.

Most of the empirical analyses of this question have been based on the employers' portion of the Social Security tax--a payroll tax similar to UI, except that all employers pay the same tax rate on earnings up to the same amount. 16/ The results of these studies have been mixed, however, and

TABLE 10. ESTIMATED DISTRIBUTION OF UI BENEFITS, TAXES, AND RESULTING SUBSIDIES, BY INDUSTRY, CALENDAR YEARS 1976-1981

Industry	Percent Distribution		Taxes Paid Per Dollar of Benefits Received a/	Subsidy Per Worker Per Year a/ (in dollars)
	Benefits	Taxes		
Agriculture	2.9	1.5	0.53	150
Mining	1.3	1.3	0.99	0
Construction	19.8	10.3	0.52	240
Manufacturing	38.0	35.9	0.94	10
Transportation, Communication, and Public Utilities	6.4	6.0	0.94	10
Wholesale Trade	3.5	7.5	2.12	-80
Retail Trade	11.6	16.0	1.37	-30
Finance, Insurance, and Real Estate	2.8	5.8	2.09	-70
Other Services	13.7	15.7	1.15	-10

SOURCE: Congressional Budget Office, based on benefit data from March Current Population Survey, 1977-1982; tax and employment data from Bureau of Labor Statistics, ES-202, 1976-1981.

a. These estimates are only approximate because they combine benefit and tax data that are not strictly comparable.

16. See John A. Brittain, "The Incidence of Social Security Payroll Taxes," *American Economic Review*, 61:1 (March 1971), pp. 110-125; Wayne Vroman, *Employment Termination Benefits in the U.S. Economy*, Employee Benefit Research Institute (1983), pp. 92-99; Daniel Hamermesh, "New Estimates of the Incidence of the Payroll Tax," *Southern Economic Journal*, 45:4 (April 1979), pp. 1208-1219; and Feldstein, "The Incidence of the Social Security Payroll Tax," pp. 735-738. The Social Security tax also differs from the UI one because workers contribute directly to the Social Security tax.

there is not yet a clear consensus about who actually pays what share of the tax. In general, the studies have found that most of the employers' part of the Social Security tax is eventually paid by workers in the form of lower wages and by consumers through higher prices, but the timing of these cost shifts and the distribution between wage and price changes have yet to be agreed on. Some of the studies suggest that, during roughly the first year after a change in the payroll tax, employers absorb most of the cost increase, but thereafter they shift perhaps one-quarter to one-half of the tax to workers in lower wage increases and shift much of the rest to consumers in price increases.

The analysis for UI is more complicated because different employers pay different tax rates and because the UI tax is small compared to the Social Security tax. According to some research, only that tax paid by the least-taxed firm potentially can be transferred to workers and consumers in a competitive market, suggesting that at least in some cases a larger share of the UI tax than of the Social Security tax is paid for through lower profits. 17/ The fact that different firms in the same industry generally have similar tax rates probably limits the amount of the UI tax that firms must absorb, however. 18/

EFFECTS OF THE UI PAYROLL TAX ON FIRMS

Although it is likely that firms ultimately pay only a relatively small portion of the UI tax, it can still have a significant impact on their behavior for several reasons. 19/ First, because of lags in price and wage changes, employers probably do bear most of the added cost during the first few quarters after the tax is raised. Second, that portion of the tax finally absorbed by firms does reduce profits and could potentially influence their financial viability. Considerably less research has been done on the effects of the tax on firms than on the effects of benefits on workers, however, primarily because of a lack of data on tax rates actually paid by firms.

---

17. See Frank Brechling, "Unemployment Insurance Taxes and Labor Turnover: Summary of Theoretical Findings," *Industrial and Labor Relations Review*, 30:4 (July 1977), pp. 483-494.

18. This could occur because many workers probably have employment opportunities limited to a given industry, and, thus, the least-taxed firm might be relevant only to the industry in question.

19. As noted in Chapter II, the availability of UI benefits to their workers also prompts firms to increase temporary layoffs.

The presence of the UI tax, itself, raises the cost of labor relative to other production inputs, and probably reduces the demand for labor services somewhat. Compared to the Social Security payroll tax, however, the UI tax is relatively small--both in terms of the tax base and of the tax rate--and is likely to have a smaller impact on the behavior of firms.

Two features of the UI tax distinguish it from the employer portion of the Social Security tax, however--namely, the experience-rating structure of state UI taxes and the small taxable wage base. These features can provide significant incentives for some firms to adjust their employment policies.

Effects of Experience Rating on Firms

Experience rating of UI taxes can have several effects on the employment policies of firms. First, an experience-rated tax generally makes employers less willing to lay off existing workers because the firm's tax liability usually depends on its layoff history. Firms can minimize layoffs both by stabilizing output and by changing the length of the workweek for existing employees. Second, experience rating affects firms' hiring decisions by causing them to limit the hiring of workers who could be financial liabilities in the future. This might result in limitations on hiring overall or only for workers in certain types of jobs. Finally, experience rating provides employers with an incentive to control benefit payments to former employees by helping UI administrators screen UI claims for eligibility.

Because UI taxes are not completely experience-rated, however, many layoffs do not increase employers' tax rates. Further, even if firms are charged for layoffs, it can take several years for tax increases to reflect fully the added costs of benefits. Because tax rates tend to be similar for firms in the same industry--apparently reflecting broad similarities in output variability and employment experiences of the workers--incomplete experience rating also results in a cross-subsidization of UI costs among industries rather than among firms in the same industry. Consequently, output and employment tend to be increased in subsidized industries, including such seasonal ones as construction and agriculture, and decreased elsewhere. 20/

Compared to complete experience rating, the current incomplete system raises the occurrence of temporary layoffs, although the magnitude

20. See Hamermesh, *Jobless Pay and the Economy*, p. 65.

of this effect has not been estimated accurately to date. 21/ Based on available information, temporary layoffs attributable to incomplete experience rating can increase the occurrences of unemployment in the economy by roughly 5 percent to 15 percent, although there is considerable disagreement on this point. Only fragmentary information is available on other effects of incomplete experience rating.

Effects of a Small Taxable Wage Base

Because of the small earnings base on which federal and state UI taxes are calculated, a large share of the wages of many workers is not taxed. In 1983 about two-thirds of all workers had earnings above the $7,000 federal tax base. Overall, wages and salaries subject to UI taxation represented only about 30 percent of the total paid in that year.

The small base implies that firms paying relatively high wages, and especially those with low labor turnover, pay UI taxes on a smaller share of total wages than other firms. For example, in states with a tax base identical to the federal one, the maximum federal and state tax liabilities per worker are reached when a full-time worker earns slightly more than the federal minimum wage of $3.35 per hour. In addition, hiring two persons for six months each at $10,000 costs twice as much in UI taxes as hiring one person for 12 months at $20,000. Thus, a small tax base imparts a bias against hiring low-wage, part-time, or part-year workers. For the same reasons, however, it also discourages labor turnover.

The limit on the tax base can also influence the way an employer reacts to changes in product demand. When demand increases, a firm has an incentive to increase the hours worked by existing employees rather than to add new workers, because increasing hours generally does not add--or add as much--to the firm's UI tax liability. Similarly, when product demand decreases, the low tax base also provides an incentive for firms to reduce hours rather than employment.

Finally, a small tax base can limit the effectiveness of experience rating by limiting the effect of tax-rate differences on tax receipts, although this result is less clear. For a given set of tax rates, an increase in

---

21. Theoretical work on the effects of limitations on experience rating on unemployment is found in Martin Neil Baily, "On the Theory of Layoffs and Unemployment," *Econometrica*, 45:5 (July 1977), pp. 1043-1063; Frank Brechling, "The Incentive Effects of the U.S. Unemployment Insurance Tax," in Ronald G. Ehrenberg, ed., *Research in Labor Economics*, vol. 1 (1977), pp. 41-102; and Martin Feldstein, "Temporary Layoffs in the Theory of Unemployment," *Journal of Political Economy*, 84:5 (October 1976), pp. 937-958.

the tax base would increase the taxes paid by both high- and low-tax-rate firms, but there is reason to believe that the degree of experience rating might increase. In states using the reserve-ratio method of experience rating, raising the tax base generally would result in reductions over time in the tax rates actually paid by most firms. This would occur because the increased tax payments attributable to the change in the base would raise their reserve ratios. In addition, however, firms at the maximum tax rate might also pay more in total taxes over time if their unemployment experiences were such that they remained at the maximum tax rate, tending to increase the degree of experience rating. On the other hand, firms at the minimum tax rate would also pay more in taxes because their tax rates could not fall, thereby acting to lessen the degree of experience rating.

If the tax base were increased while holding total revenue constant by reducing tax rates, the effect on experience rating would depend on how the rates were lowered. If the maximum tax rate remained constant while other rates were reduced, then the degree of experience rating would probably rise for the reasons cited above. On the other hand, if all tax rates--including the maximum--were reduced in proportion to the increase in the base, then the degree of experience rating would remain nearly the same.

CHAPTER IV

ISSUES ABOUT THE PROVISION OF UI AID TO FUTURE JOBLESS WORKERS

Opinions differ about how well Unemployment Insurance has accomplished its goals in recent years, and about what the program's role should be in helping future jobless workers. The UI system is criticized by some for making unemployment too attractive both to workers and to firms, while it is blamed by others for providing inadequate or inappropriate aid. The relative ease with which UI benefits are available and the potentially long duration of aid have been cited as ways in which UI encourages workers to become unemployed and to remain so for too long. The tax structure of UI is also blamed for not providing firms with adequate incentives to hold down unemployment. Others maintain that the system reacts in a slow and inefficient manner at the onset of recessions--waiting too long to enact benefit extensions and then only making ill-planned changes. Still others criticize UI for not providing reemployment assistance to jobless workers in addition to cash aid.

This chapter considers some of the major policy choices confronting the future of the UI program. These choices center on three basic questions about the nature of Unemployment Insurance benefits and taxes:

- Could the program's incentives for workers and employers be changed to reduce unemployment without seriously restricting the income support role of UI?
- Should the program be modified during future periods of high unemployment to provide more aid to long-term jobless persons?
- Should UI funds be used more aggressively to promote the reemployment of program recipients?

COULD THE INCENTIVE STRUCTURE OF UI BE CHANGED TO REDUCE UNEMPLOYMENT?

Although the Unemployment Insurance system contains incentives that increase and decrease joblessness, on net UI increases unemployment.

Factors tending to raise joblessness include the availability of benefits themselves, which reduce the cost to workers of being unemployed; incomplete experience rating of UI taxes, which results in some firms paying less than the full cost of benefits received by their former workers; and the fact that UI benefits allow firms to lay off valuable workers temporarily with relatively low risk of losing them to other employers. Factors tending to reduce unemployment include the potentially better job matches between workers and firms made possible by the income support available while searching for work; the likelihood that some persons will work more to become eligible for future UI aid; and the partial relationship between a firm's unemployment experience and its UI tax rate. In total, however, empirical estimates cited earlier suggest that the net impact is to increase joblessness.

Thus, the question is not whether UI increases unemployment, but whether there are aspects of UI that could be changed to reduce joblessness without diluting the program's ability to meet its income-support goal. For workers, since the employment disincentives of UI derive mainly from the availability of cash benefits while unemployed, UI benefit amounts and the conditions under which benefits are available are the primary program features to consider. The problem is to reduce the attractiveness of receiving aid while still providing sufficient income support. The difficulty of this task is heightened by the historically low fraction of job losers who now receive UI benefits, however, and the desire on the part of some not to reduce this fraction further.

For firms, the main incentives for higher joblessness result from incomplete experience rating of UI taxes. If a greater share of benefits were financed with taxes that varied more with the employer's use of the program, employers would have a greater incentive to reduce unemployment. Thus, the program features to consider modifying are those that contribute to the shortfall in experience rating. Several problems would emerge, however, in making UI taxes more fully experience rated--for example, determining which UI benefits should be the firm's responsibility. Another difficulty would be constructing a tax-payment scheme to increase experience rating while allowing firms sufficient time to recover from the causes of their employment reductions before increasing their tax liabilities.

SHOULD UI AID BE EXTENDED DURING PERIODS OF HIGH UNEMPLOYMENT?

The adequacy of regular UI benefits in periods of high unemployment historically has become the subject of Congressional debate with each major rise in joblessness. Although the permanent Extended Benefit program has

existed since 1970, the Congress has often opted to extend further the duration of cash aid when joblessness becomes particularly high. The number of persons receiving extended aid in the future could be limited under current law, however, by restrictions in the Extended Benefit program brought about by recent program and economic changes, and by the scheduled expiration of Federal Supplemental Compensation early in 1985.

The desirability of extending UI aid in times of high unemployment depends on at least three factors: the need for providing aid longer, the role of UI in assisting jobless workers, and operational considerations such as who would be eligible and how the aid would be funded. 1/ With regard to the need for added UI benefits, cyclical rises in unemployment do correspond to increased durations of joblessness, and these might or might not justify longer periods of assistance. During the cyclically high unemployment years of 1975 and 1982, for instance, not only did the number of regular UI recipients rise dramatically, but the fraction who used all available regular benefits also increased. In both years, the exhaustion rate was about 38 percent, compared to about 27 percent in the low-unemployment years of 1973 and 1979. In addition, usually more than half of EB recipients exhaust that aid when it is available.

Debate on extending UI aid often centers on the distinction between the presumed insurance nature of UI and the welfare purpose of many other governmental cash assistance programs. As discussed in Chapter I, UI is often viewed primarily as insurance because benefits are provided to workers without regard to need, and because employers pay specific payroll taxes on behalf of each worker. Viewing UI in this light, the rationale for changing the amount of UI aid in response to changes in need might be limited since insurance benefits generally do not vary with need. Alternatively, if UI--or even that portion of UI beyond the regular program--is seen as welfare, then increases in aid that coincide with increased hardship (in this case, being unemployed when jobs are harder to find) might be more easily justified.

The argument that UI should provide the same degree of protection in good times and in bad can lend support for benefit extensions whether or not UI is seen as insurance. If the "same degree" of protection is viewed as the same likelihood of finding another job before benefits end, then it would be natural to extend the duration of aid when joblessness is high and jobs are hard to find, and to reduce benefit durations when unemployment is low.

---

1. Extending UI aid also could help stabilize the overall level of economic activity by providing added income to jobless workers.

Operational issues--including who would be eligible for assistance and who would pay for it--also influence the advisability of extending UI benefits. 2/ If UI is viewed as insurance, then benefit extensions would likely be made available to all regular UI recipients, since all have equal coverage. On the other hand, as welfare, aid could be made available only to selected recipients of regular UI. For instance, extensions of aid could be means-tested, with only those with low incomes being eligible. Eligibility could also be tied to participation in some other activity, such as enrollment in a training or retraining program.

The financial responsibility for UI extensions might rest with whomever is thought to have caused the unemployment. While regular UI is paid for by payroll taxes on employers, some argue that subsequent periods of aid should be financed, at least in part, with federal funds. High unemployment, according to this argument, is often a national problem rather than a local one--brought on, or affected by, federal fiscal, monetary, and other economic policies--and the federal government should thus assume at least partial responsibility for financing aid during extended periods of joblessness. Some also maintain that when workers have been unemployed for six months or more, their unemployment stems more from either national economic conditions or a lack of marketable skills and less from the behavior of their former employers. On the other hand, to the extent that lengthy joblessness is attributable to workers or former employers, it might be appropriate to finance benefit extensions from the UI payroll tax.

SHOULD UI FUNDS BE USED MORE AGGRESSIVELY TO PROMOTE REEMPLOYMENT?

Some have suggested that the cash aid currently provided by UI is inadequate, and that support should be broadened to include reemployment assistance. 3/ The need for such aid, which could include job-search instruction, retraining, and relocation help, has been argued on several grounds. As in the recent past, experienced workers could continue to lose their jobs permanently as a result of international competition, skill

2. The question of what type of aid should be provided is discussed subsequently in the more general context of what services UI should provide to jobless workers.

3. Two federal UI laws relate to the provision of employment and training aid. First, with the exception of funds used to pay for health insurance, UI funds can be used only to provide weekly cash assistance to the unemployed; they cannot be used directly to finance reemployment aid. Second, UI recipients cannot be denied benefits while receiving training, so long as that training is approved by the state UI agency. Definitions of acceptable training differ significantly among the states, however.

obsolescence, plant migration, and other structural changes in the economy. In addition, shifts in employment among industries and occupations that accompany changes in consumption patterns and production methods might also generate more widespread demand for worker-adjustment assistance. Finally, because the prospect of continued large federal budget deficits makes large increases in federal spending for other employment and training programs unlikely, some believe there might be a need to use UI funds more broadly.

Factors affecting the speed and size of future labor market changes are highly uncertain, however, and the potential need for future public-sector involvement is unknown. 4/ Determinants of future labor market change--such as the speed of technological advance, the gap in both the mix and level of skill requirements between old and new jobs, and future rates of economic expansion--have yet to be charted with any accuracy, for example. On the other hand, the demographic makeup of the work force will soon shift to one more dominated by experienced workers, which should change the composition of training needs more toward helping them and less towards helping new entrants. Persons between the ages of 25 and 54, for instance, are projected to increase as a share of the total work force from 62 percent in 1980 to 73 percent in 1995, and the number of persons in the labor force aged 16 to 24 is projected to decline by over 4 million during this period. 5/

While there is little disagreement about the usefulness of government-provided labor market information and limited job-search assistance for unemployed persons, less agreement exists about a larger public-sector role. At present, a presumably large, but unknown, quantity of training for experienced workers is provided in the private sector--that is, paid for by workers and their employers. If most of the benefits from these investments go to the workers and firms, then there could be little rationale for public provision of that training.

Circumstances do exist, however, in which public-sector involvement might be justified. First, if the training has beneficial effects that are not captured by the workers and firms--such as enabling the economy to adjust more rapidly to future economic and technological changes, or increasing

---

4. For an assessment of future retraining needs and the possible federal role in providing this aid, see Steven H. Sheingold and Bruce Vavrichek, "Retraining in Response to Labor Market Change: Possible Public-Sector Responses" (paper presented to the Association of Public Policy Analysis and Management, October 1984).

5. Howard N. Fullerton, Jr., and John Tschetter, "The 1995 Labor Force: A Second Look," Bureau of Labor Statistics, *Monthly Labor Review*, vol. 106:11 (November 1983), p. 5.

the nation's defense capabilities--federal support to increase that investment might be appropriate. Second, training might be provided on the grounds of equity: economic change, including technological progress, generally benefits most of society, but imposes costs on a few. Public provision of retraining would create a mechanism whereby those bearing the costs could be partially compensated and perhaps even share in some of the gains. 6/ Third, if workers are forced to limit their training because they cannot obtain loans or other financial support based on uncertain future income, the government might overcome the inefficiency in this market by providing loans.

Even if public aid is desired, Unemployment Insurance might or might not be the best vehicle to deliver that aid. On the one hand, using the UI program would permit targeting assistance on experienced workers with documented periods of joblessness who are actively looking for work. Further, if the retraining were made optional, it would also give states increased flexibility in the use of UI funds. On the other hand, financing reemployment aid with UI funds might be inappropriate because most program revenues come from the workers' former employers, who would often not gain from these investments. In addition, even with major changes in the U.S. labor market, the number of UI recipients who would require aid beyond that now available might be limited. Of those requiring major reemployment services, some probably have adequate resources to finance it without the help of UI.

6. From a political perspective, there is also a pragmatic view that, in the absence of some mechanism to alleviate their losses, those adversely affected might attempt to block economic change through the legislative process. In the long run, retraining assistance might be less costly to society than going without these changes.

CHAPTER V

OPTIONS FOR CHANGE

Proposed changes in Unemployment Insurance are based on a wide range of political perspectives. The goals of these initiatives are also diverse, ranging from reducing the program's incentives to create joblessness to expanding or modifying the aid available to future unemployed workers.

Most options considered here do not represent radical departures from current program practices, but they could alter the tone and function of future UI support. For example, one change would require workers and firms to contribute to a fund that could later be used for employment and training aid. Another would make employers responsible for only a limited period of jobless support, but would make the cost of that aid a direct obligation of the firm. If enacted, the options considered here could provide either minor adjustments in a program whose role in future labor markets would remain largely unchanged, or they could set a precedent for future, more sweeping, changes in UI.

Major modifications in federal UI laws have occurred infrequently during the program's nearly fifty years of existence. Perhaps the main reason is that, for many recipients, the program seems to work. The majority of program beneficiaries do not use all available aid, presumably because they become reemployed before exhausting benefits, and the current form of cash assistance helps them bridge the gap between jobs. Another reason for program stability is that workers and employers--as well as state and federal levels of government--have very different interests in the program, and it is difficult to find agreement on change. Even with the major shifts in the U.S. labor market that have occurred in the past half century, a consensus for new policies in UI has seldom been reached.

Nonetheless, many persons today find the arguments in favor of new approaches to be persuasive, and have developed specific proposals. The remainder of this chapter analyzes several options to address the issues described in Chapter IV, including those to:

- Change the incentive structure of UI to reduce unemployment;
- Extend program aid during periods of high unemployment to help the long-term jobless; and

- Use UI funds more aggressively to promote reemployment of program recipients.

CHANGING PROGRAM INCENTIVES FOR WORKERS AND FIRMS

Unemployment Insurance could be modified in two basic ways to reduce unemployment: alter the work incentives for employees, and allocate more of UI costs to employers responsible for joblessness. In both cases, the intent of the change would be to reduce unnecessary use of the program primarily by limiting the attractiveness of UI to workers or firms.

Modify Work Incentives For Employees

Options intended to alter the work incentives in UI include selectively reducing the value of that aid to workers and increasing the efficiency of their job-search efforts. Although the simplest way to reduce the program's incentive to increase joblessness would be to cut benefits, few argue that the current level of weekly UI benefits are excessive. Thus, the options considered here are more modest in scope. Particular ones include:

- Requiring a two-week waiting period before receiving UI benefits;
- Tightening enforcement of job-search and other eligibility requirements; and
- Providing mandatory job-search instruction.

Require a Two-Week Waiting Period Before Benefits Are Available. The federal government could require UI beneficiaries in all states to wait two weeks before initially receiving benefits. 1/ The maximum length of time a jobless person could collect benefits would not be affected by this change. For example, a person otherwise eligible for 26 weeks of aid would remain eligible for that amount, but the payment period would cover weeks 3 through 28 of joblessness. Total benefits would be reduced, however, for those recipients who did not exhaust all available assistance. Under current state laws, 42 states require beneficaries to wait one week before receiving regular benefits; the remaining states have no waiting period.

This delay in benefits would encourage faster and more intensive job search--possibly while workers still are employed--to avoid the initial period

1. This change could be accomplished by making this restriction an additional criterion for federal approval of the state's UI program. See Chapters I and III for details.

without aid. Without taking account of the reduction in joblessness that could result if the number of episodes of unemployment were to decline, this change could reduce outlays for regular UI by about $900 million in fiscal year 1987--the first year this policy change could be implemented because of delays in changing state UI laws--and by nearly $3.6 billion during the fiscal year 1987-1990 period. If 80,000 fewer workers became unemployed in fiscal year 1987 as a result of this delay--representing about one percent of all UI recipients in that year--additional savings of roughly $80 million might be obtained, although this effect is highly uncertain.

While proponents of this option cite its potential to reduce joblessness without reducing benefits for the long-term unemployed, others point out that it would reduce total benefits for the majority of UI recipients. About two-thirds of all program recipients do not exhaust benefits, and the total aid they receive would be cut by this delay. Others object to this change because they see it as a potential intrusion by the federal government into the benefit provisions of state UI programs--a power the federal government has only infrequently exercised in the history of the UI program.

Tighten Eligibility Enforcement. Closer checking and more vigorous enforcement of job-search and other eligibility requirements could induce some UI recipients to increase their work-search efforts while they are receiving benefits and could reduce unwarranted benefit payments. A large and complex program like UI provides ample opportunity for some recipients who do not follow all the rules to receive aid. Some rules--including requiring that recipients actively search for work and accept job offers that generally match their qualifications--are sometimes difficult to interpret and often more difficult to enforce. In any case, stricter enforcement of eligibility rules would provide an incentive for certain workers to become unemployed less frequently and to end their spells of joblessness sooner.

In 1981 the Labor Department started a small-scale pilot program in five states, called the Random Audit program, to determine the nature and extent of benefit overpayments. 2/ This program reviewed in detail the

2. The five states included in the pilot program were Illinois, Kansas, Louisiana, New Jersey, and Washington. See Paul L. Burgess, Jerry L. Kingston, and Robert D. St. Louis, "The Development of an Operational System for Detecting Unemployment Insurance Payment Errors Through Random Audits: The Results of Five Statewide Pilot Tests," Contract Report prepared for the U.S. Department of Labor (December 1982). For an evaluation of the Random Audit program, see U.S. General Accounting Office, *An Assessment of Random Audit--A New Department of Labor Program To Improve The Accuracy of Unemployment Insurance Benefit Payments* (March 30, 1984). For an earlier study conducted in six cities, see Burgess and Kingston, "Estimating Overpayments and Improper Payments," in National Commission on Unemployment Compensation, *Unemployment Compensation: Studies and Research*, vol. 2 (July 1980), pp. 487-526.

work histories of randomly selected UI recipients, their reasons for job separation, and their work-search and other activities while receiving benefits. The results of the pilot study indicated that benefit overpayments accounted for an estimated 14 percent of total benefits in the five states considered, ranging from 7 percent of benefits to 24 percent across the states. 3/ The overwhelming reason for overpayments was a failure to seek work actively while receiving aid, accounting for between 50 percent and 80 percent of all overpayments across states. Fraud represented a very small fraction of overpayments--between 0.2 percent and 2.7 percent.

The Department of Labor is scheduled to implement a nationwide UI "quality control" program in July 1985. This program will expand the area of inquiry to include both eligibility determinations and benefit payments for workers and tax payments for firms, and also will increase the number of audits to an annual average of 1,200 per state. The quality control program will be implemented in all 50 states, the District of Columbia, and Puerto Rico, at a projected fiscal year 1986 cost of slightly over $30 million, or about $500 per audit.

Proponents of programs like quality control maintain that continued support of these efforts will go a long way toward reducing improper payments and unintended work disincentives in UI. Further, they contend that if UI benefit payments were reduced by even one percent through the detection of erroneous payments, the one-year saving from the quality control program could pay for its operation for five years.

Opponents resist this approach on several grounds. Some see it as a potential way to harass or intimidate program recipients. They fear that many otherwise eligible workers would not apply for aid because of the possible retrospective penalties associated with these checks. Others maintain that such in-depth probes would violate the worker's privacy, and should only be used when information exists that incorrect benefit amounts were paid. Still others feel that, since it is primarily state funds that are allegedly being improperly spent, it should be the states' concern.

---

3. The fraction of the weeks of benefits paid that included either overpayments or underpayments was considerably higher--ranging from 12 percent to 52 percent. Underpayments were estimated to represent less than one percent of total benefits, although the methodology used in the audit probably understated that amount. It only considered those persons who actually received benefits and not persons whose claims were denied or who did not apply.

Provide Mandatory Job-Search Instruction. Requiring UI recipients who are not simply on layoff to take a limited amount of job-search instruction could better equip them to look for work. UI recipients often have held steady jobs for many years and know little about how to look for work efficiently or what institutions are available to aid them. Mandatory instruction could be limited to a one- or two-day seminar on job-search techniques and resources. If successful, this aid could enable workers to find suitable employment more quickly or to discover better job opportunities.

In good economic times, limited job-search assistance might shorten unemployment by about two to three weeks on average. In addition to helping workers find better jobs, this aid might also reduce total UI outlays if the resulting reduction in the duration of UI benefits more than offset the cost of job-search assistance. Based on experience under the Comprehensive Employment and Training Act, the average cost of this aid could be between $100 and $200 per worker in fiscal year 1986, compared with the average weekly UI benefit of about $125. 4/ Providing this limited form of job-search aid to one-third of all UI recipients in fiscal year 1986 would cost about $400 million.

Mandatory job-search aid would be less likely to help UI recipients find jobs when the economy is sluggish or in recession, however. The lack of adequate job opportunities could frustrate even well-prepared job seekers then, and even if UI recipients did find jobs, they might be at the expense of employment for other workers. In addition, some UI recipients might need more than simple job-search aid to become reemployed, either because their skills are outmoded or jobs in their line of work are generally hard to find.

Reallocate UI Costs Among Employers

Although experience rating of UI taxes is intended to stabilize employment, it could be having only limited success. The actual degree of experience rating in certain states apparently is somewhat low, so that UI might be providing some employers with little incentive to economize on layoffs and stabilize employment. As a result, firms could be sharing more equally in paying for benefits than their workers are in using them.

---

4. See Congressional Budget Office, *Dislocated Workers: Issues and Federal Options* (July 1982), p. 44; and "Strategies for Assisting the Unemployed (unpublished Staff Working Paper, December 8, 1982). These estimates support the contention that limited job-search instruction might, in net, reduce total UI outlays.

Several options have been proposed to modify the UI payroll tax to alter the current distribution of UI costs among employers. Options considered here include those to:

- Widen the range between minimum and maximum state employer tax rates;
- Redefine the unemployment for which employers are responsible;
- Increase the federal taxable wage base in UI.

Widen the Range of State Employer Tax Rates. The sensitivity of firms' state UI tax liabilities to the UI experiences of their workers could be increased by raising the maximum tax rate or lowering the minimum rate in state UI laws. The larger the difference between these tax rates, the greater is the incentive for firms to use their work forces more efficiently, including reducing unemployment. 5/ This incentive could also be enhanced by increasing the number of "steps" between the minimum and maximum rates, so that firms with tax rates between these extremes would have more incentive to keep layoffs and terminations low.

It is unrealistic to think that the federal government could set minimum and maximum tax rates that would fit the circumstances of all states, however. Instead, if a federal mandate were desired, it might specify that at least a certain share--such as 50 percent to 70 percent--of UI costs in each state be effectively rated by experience. 6/

An increase in the degree of experience rating might also affect the distribution of employment among industries and firms. For firms that are now charged less than the cost of benefits to former workers, including many firms in seasonal and cyclical industries, this change could increase the cost of labor and act to decrease their employment. On the other hand, it could reduce labor costs for firms that are now charged more than the cost of benefits, thereby tending to increase employment in more stable industries.

---

5. See, for example, the Committee for Economic Development, *Strategies for U.S. Industrial Competitiveness* (1984); and Kenneth McLennan, "Policies to Stimulate the Hiring of the Long-Term Unemployed and Permanently Displaced Workers," statement before the Senate Subcommittee on Employment and Productivity (January 12, 1983).

6. Minimum tax rates would still need to be above zero to pay for pooled benefit costs, however, as all firms presumably would continue to share in the costs of extended benefits, noncharged benefits, and those benefits paid to jobless workers whose employers have gone out of business.

Proponents of this change argue that the current UI tax structure penalizes firms with successful employment policies by overcharging them on their state UI tax, and that increasing the degree of experience rating in this way would help reduce the problem. Some also maintain that this change would improve workers' adjustments to structural change because firms would have a stronger incentive to inform workers accurately about the likelihood of recall. Finally, still others suggest that this option would increase the accuracy of UI benefit payments, because firms would be more likely to monitor benefits paid to their former workers if their tax liabilities more directly reflected these costs.

On the other hand, this change would result in added burdens being placed on some firms and could reduce employment in some areas. Employers enduring bad economic times by laying off large numbers of workers, for instance, might soon have to pay larger UI taxes as well--potentially further threatening their economic viability.

Redefine the Period of Unemployment for Which Employers Are Responsible. Another way to tie the employment policies of firms more closely to their state UI taxes would be to charge them for the entire cost of the early weeks of joblessness experienced by their workers, while making them less liable for later weeks of aid. Under current state laws, employers have the same degree of liability for each week of regular jobless benefits. The specific tax liabilities of firms for particular weeks of aid could be adjusted so that this change would have no effect on total revenues, or they could be designed to raise or to lower receipts. Detailed estimates of particular options are not presented because of data limitations, however.

The rationale for this change is that, although full experience rating is optimal for temporary layoffs, it is not necessarily so for permanent layoffs because it inappropriately discourages new hiring and desirable layoffs. 7/ Although the empirical evidence is not definitive, some persons attribute a large share of temporary-layoff unemployment to incomplete experience rating of UI taxes. This change would provide an incentive for employers to reduce temporary layoffs and to recall short-term unemployed persons more quickly; it would reduce the incentive to recall those on long-term layoff, however.

Other support for this proposal comes from those who view early periods of unemployment as being more closely linked to the actions of the former employer than unemployment that continues for several months.

7. See Martin Feldstein, "The Effect of Unemployment Insurance on Temporary Layoff Unemployment," *American Economic Review*, 65:5 (December 1978), pp. 834-846.

According to this view, extended periods of joblessness are often caused more by poor overall labor market conditions or the particular characteristics of the worker than by the actions of the former employer.

This change is opposed by others on the grounds that it would penalize firms whose production schedules require short periods of down-time, and would benefit those firms who lay off workers for longer periods of time, even though the cost per week of unemployment to the UI system would be the same. In addition, for long-term jobless persons, this change could sever the direct link between the worker and the firm, further reducing any remaining possibility that the worker would be reemployed in his old job.

Increase the Federal UI Taxable Wage Base. Increasing the UI taxable wage base generally has been proposed as a way to raise program revenues, but it would also affect the overall distribution of UI costs among employers. The federal UI wage base--which also serves as the minimum base for state UI taxes--is currently $7,000 per worker, and has been increased only three times from its level of $3,000 in 1940. During that period, the proportion of wages subject to the federal tax has fallen from over 90 percent to about 40 percent.

Raising the taxable wage base could increase UI costs relatively more for firms paying high wages, and especially those with low labor turnover, than for low-wage and high-turnover employers. In doing so, it would reduce the bias against employing low-wage workers created by the current low tax base. The effects on experience rating, however, would depend on the size of the increase in the base, the distribution of firms at various tax rates, and whether tax rates were also changed.

Several possibilities exist for raising the tax base, including indexing it to average wage changes in the economy, increasing it to some share--perhaps 50 percent--of average annual wages, or both increasing it and indexing that higher level to future wage changes. Although relatively small increases in the base might be accomplished without the need to recalibrate UI tax rates, larger increases--such as raising the base to one-half of average wages--might require more extensive changes in tax rates to offset sudden large increases in revenues. If changes in the federal wage base were linked to changes in average earnings in the national economy--as is done with the Social Security taxable wage base--state and federal tax revenues would increase by $400 million in fiscal year 1987, and by a total of $4.3 billion during fiscal years 1987 through 1990. 8/

8. These estimates assume that the change is implemented in January 1987, to allow time for changes in state UI laws.

By concentrating most of the tax increase on the wages of workers now earning more than the current tax base, this change would make the UI tax more progressive. In addition, this change could help to stabilize the long-term financial position of the UI system by allowing revenue increases to follow the same path as benefit gains. It would reduce the need for further increases in tax rates, which have risen from an average of 1.3 percent of taxable wages in 1970 to about 3 percent today. On the other hand, this change could result in higher labor costs for employers, and might have adverse effects on the level of employment. It also would reduce the flexibility of states in designing tax systems by mandating increases in at least some state UI tax bases, although states in good financial condition could offset this change by lowering tax rates.

EXTENDING UI DURING PERIODS OF HIGH UNEMPLOYMENT

If desired, extensions of program aid during periods of high joblessness could be constructed in several ways. Cash assistance could be continued beyond that available in the regular UI program, loans could be provided to long-term jobless persons, or other types of services could be made available. Options considered here are for the first two types of aid--assistance in the form of cash grants or loans. A third possibility--providing employment and training services--is discussed in the next section of this chapter as an alternative to cash assistance in UI more generally.

This section examines criteria in the design of UI aid programs for long-term jobless workers, provides a detailed look at one particular proposal to extend cash assistance that was introduced in the 98th Congress by Senators Byrd, Heinz, and others, and considers the provision of loans as an alternative to cash grants.

Design Criteria

Along with the broader issues of eligibility and financing discussed in Chapter IV, basic features in the design of programs to extend UI include the conditions under which that aid would be provided and, for weekly assistance, the duration of the benefits. 9/

9. The weekly benefit level also could be changed for workers receiving extensions of aid, although few proposals specify a level different from that in the regular program. Increases in weekly benefits could be supported on the grounds that the degree of hardship increases the longer the worker remains unemployed. Alternatively, decreases in weekly benefits could be supported as a way of gradually reducing the work disincentives of the program.

Under current law, Extended Benefits are available for one-half the duration of regular benefits, up to 13 weeks, when a state's insured unemployment rate exceeds certain thresholds. 10/ These benefits are payable when the state IUR is both at least 5 percent, and 20 percent higher than during the same period in the prior two years. At a state's option, Extended Benefits are also available when the IUR is at least 6 percent, without having to meet the 20 percent criterion. Federal Supplemental Compensation is available for a maximum of 8 to 14 weeks, with the exact duration determined by the IUR in each state and the average rate of insured unemployment since the beginning of 1982.

Triggering Mechanisms. The two indicators discussed most often as mechanisms for initiating UI benefit extensions are the insured unemployment rate and the total unemployment rate. 11/ In spite of their general appeal as measures of labor market tightness, however, each has been criticized as potential triggering mechanisms for UI extensions. The main difficulty with the IUR as an indicator of the need for extensions of aid--either in grants or in loans--is that it only counts as unemployed those persons receiving regular UI benefits; it does not count persons who have exhausted benefits or other unemployed persons who do not receive aid. Because these persons also compete with UI recipients for jobs, some maintain that the IUR does not accurately reflect tightness in the labor market. The TUR, on the other hand, includes a much broader definition of jobless workers, but this also limits its usefulness for triggering UI benefit extensions. By including new entrants and reentrants into the labor market, the TUR includes many young and inexperienced workers who do not directly compete for jobs with more experienced UI recipients.

Despite the shortcomings of the IUR and TUR as trigger mechanisms, no other method of initiating benefit extensions has been proposed that is clearly superior. One suggestion is to use the benefit-exhaustion rate for regular UI, which would seem to be a natural method for indicating the need for UI extensions because it directly measures the number of persons who might be eligible for that aid. Only limited information on exhaustion rates

10. The insured unemployment rate is the number of regular UI recipients relative to the number of workers in covered employment.

11. The total unemployment rate is the ratio of all active job seekers to the civilian labor force. See Chapter II for information on recent movements in the IUR and TUR at the national level.

is collected now, however, so that this indicator can not be demonstrated to be desirable. 12/

Another possibility would be to use the mean (or median) duration of regular UI benefits, because it would also seem to be an appropriate indicator of labor market tightness. Unfortunately, this is not necessarily the case. When unemployment increases, the average duration of UI benefits usually falls rather than rises, because newly unemployed persons have drawn benefits for a shorter period. On the other hand, when the jobless rate decreases, the average duration of benefits often rises because there are fewer newly unemployed persons to bring down the average.

Given the apparent lack of alternatives to determine when to extend UI benefits, one approach would be to move toward more geographical disaggregation of IUR and TUR data. Because labor market areas often do not conform to state boundaries--either because there are several distinct labor market areas within one state or because labor market areas cross state lines--some analysts have long advocated the use of substate triggers for enacting UI benefit extensions. The main difficulty in implementing them is the lack of accurate local data on unemployment and the lack of clear definitions of local labor markets.

Recent studies by the Department of Labor (DOL) and the General Accounting Office (GAO) confirm the difficulties in creating substate triggering mechanisms. 13/ In assessing this issue, the Department of Labor concluded that "it is not currently feasible to implement a substate program which follows the generally accepted principles upon which current UI programs are based and meets reasonable standards of accuracy and timeliness." 14/ To develop such a program would require at least two years and a significant increase in resources, as well as the resolution of difficult policy and technical questions, according to DOL.

---

12. As mentioned in Chapter II, although the number of persons receiving final payments (exhaustions) is measured properly, the share of all UI recipients doing so is not. The exhaustion rate is approximated as the number of final payments divided by the number of first payments (new recipients) six months earlier. For instance, the exhaustion rate in the third quarter of a year is approximated as the number of final payments in that quarter divided by the number of first payments in the first quarter of that year.

13. "The Feasibility of Using Substate Areas for the Payment of Unemployment Benefits," submitted by the Secretary of Labor to the Congress on June 5, 1984; and U.S. General Accounting Office, *Reliable Local Unemployment Estimates: A Challenge for Federal and State Cooperation* (July 27, 1979).

14. Secretary of Labor, "The Feasibility of Using Substate Areas," page ii.

The Duration of Cash Benefits. Short of providing benefits for an entire spell of unemployment--which would provide overwhelming work disincentives in addition to being prohibitively expensive--there must be a cut-off point after which aid is not available. There is, however, no objective way to determine the best point.

One possibility is to attempt to provide the same degree of aid with regular and extended benefits in bad times that is provided by regular benefits alone in normal times. Using an approximation of the benefit exhaustion rate as the measure of the adequacy of aid, for example, one study concluded that during the 1973-1975 recession the combination of regular and Extended Benefits would have been sufficient to equate the protection provided by regular benefits in normal times. 15/ That is, the percent of UI recipients exhausting both regular and Extended Benefits during 1973-1975 was about the same as the percent of UI recipients exhausting regular benefits alone in nonrecessionary times. Proportionately more aid was provided to jobless workers during that recession than in normal times, however, because Federal Supplemental Benefits were also available.

Similar comparisons are difficult to make for the more recent recessions of 1980 and 1981-1982 for several reasons. Program and economic changes occurring during those periods caused exhaustion rates to fluctuate considerably, and they did not correspond to the usual pattern of uniformly higher exhaustion rates in recessions than in normal times. In addition, the availability of FSC benefits for very different lengths of time in different states makes the exhaustion rates for FSC noncomparable across states.

One major difference between the durations of current EB and FSC benefits can be noted, however. Extended Benefits generally either are available for 13 weeks or are not available at all. The potential duration of FSC benefits, on the other hand, is determined by the unemployment rate in each state. While the variable duration of FSC aid makes the program more complicated, it does tend to provide aid more in proportion to the degree of the problem.

The Byrd-Heinz Proposal

A bill offering specific proposals in several of the areas discussed above was introduced in the 98th Congress by Senators Byrd, Heinz, and others. 16/

15. Walter Corson and Walter Nicholson, *Extending Unemployment Insurance Benefits During Recessions: Lessons From The FSB Experience* (Princeton, N.J.: Mathematica Policy Research, May 1980).

16. A similar bill, H.R. 1072, already has been introduced in the 99th Congress by Representative Pease and others.

This proposal would combine the existing EB and FSC programs into a permanent extension program for cash grants that would be available in a state depending on the levels of its insured and total unemployment. The number of weeks of added benefits would rise as either the IUR or TUR in the state rose (see Table 11). For example, exhaustees of regular UI

TABLE 11. UI BENEFIT DURATION, TRIGGER RATES, AND COST SHARING UNDER THE BYRD-HEINZ PROPOSAL
(In percents)

Added Weeks of Benefits a/	State Trigger Rates b/			Cost Sharing c/		
	IUR					
	Rate	Percent of Prior Years d/	TUR	State	Federal UI	Federal General Revenue
0	0-4	--	--	--	--	--
10	4-5	130	9	50	50	0
20	5-6	105	10	40	45	15
25	6-7	105	11	30	35	35
30	7+	105	12	20	20	60

SOURCE: Congressional Budget Office based on materials relating to S. 1784, introduced in the 98th Congress.

a. In addition, when the national seasonally adjusted TUR reaches 10 percent or more, five additional weeks of benefits would be paid in each tier. These added benefits would be funded from federal general revenues.

b. Benefits would be available either if both IUR criteria were satisfied or if the TUR exceeded the given thresholds.

c. Percent of costs paid by state UI programs, federal UI program, and federal general fund.

d. IUR must be at least this percent of its average in the same week of the previous six years to meet this criterion. Also, if a state qualifies for a particular tier on the basis of its IUR, but fails to qualify on the basis of IUR as a percentage of prior years' rates, it automatically qualifies for the next lower tier.

benefits in a given state would receive 10 weeks of added UI benefits under two basic circumstances--either if the IUR was between 4 and 5 percent (and was at least 130 percent of the average during the last 6 years) or if the TUR was between 9 and 10 percent. 17/ Longer benefit extensions would be available with higher state IURs and TURs. In addition, if the TUR for the nation exceeded 10 percent, five additional weeks of benefits would be available in all states.

Under this proposal, the federal government would pay a higher share of the costs of these benefits as jobless rates increased and, within those contributions, the share of benefits paid for with federal general revenues would also increase. In the example above, the cost of 10 weeks of added benefits would be paid equally with state and federal UI funds. Longer extensions of aid would be financed increasingly with federal UI and federal general revenue funds. Finally, the five weeks of added benefits available when the national TUR exceeded 10 percent would be paid for entirely with federal general funds.

The estimated cost of this proposal--$900 million for the fiscal year 1986-1990 period--reflects relatively low projected jobless rates. Under CBO's most recent economic assumptions, the unemployment rate is projected to decline from about 7 percent in fiscal year 1986 to 6.3 percent in fiscal year 1990. 18/ Costs could be considerably higher, of course, if the economy were to perform less well and joblessness increased.

Although any such proposal is necessarily arbitrary in assigning trigger rates and benefit durations, supporters of this bill cite its main advantages as providing durations of benefits that increase with rising joblessness, and as using both IUR and TUR triggers to initiate aid. Opponents contend the program would provide aid for excessive periods--possibly requiring increases in either federal or state UI taxes--and would provide too strong incentives for workers to remain unemployed.

---

17. Jobless workers also would qualify for 10 weeks of added benefits if the state IUR was between 5 and 6 percent, but was less than 105 percent of the average during the last six years.

18. In addition to forecasting economic activity for 1985 and 1986, CBO also prepares projections of key economic indicators through 1990. These projections are not a forecast of economic performance. They assume that real Gross National Product and labor productivity will grow at rates equal to their average growth in the eight-year period following earlier postwar recessions. Such periods typically contain at least one recession, and the current projections do not rule out a recession. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1986-1990* (February 1985), p. 39. Under current law, the estimated cost of Extended Benefits is less than $100 million for the fiscal year 1986-1990 period.

Loans For Jobless Workers

Rather than extending cash grants to exhaustees of regular UI benefits, others have proposed providing loans that would be repayable after the workers become reemployed. 19/ The interest rate on these loans could be set at various levels--the marginal or average cost of borrowing to the federal government, or even lower if a greater subsidy were desired--or the government could guarantee the repayment of private loans. If the government provided the loans, the loans also could provide additional subsidies by not accruing interest until the workers became reemployed or until after a certain period of time had elapsed. Although some have suggested that the federal government, rather than the states, would need to provide the capital for these loans because state UI programs typically do not have large amounts of excess funds, this would not preclude states from subsidizing interest payments or other program costs.

The cost of a federal loan program would depend on its specific content, including the interest rate, the amount of the loans, and the repayment timetable. The cost also would depend on use of the program by jobless persons which, in turn, would depend on eligibility criteria and whether other benefits were also available. Specific proposals have yet to be offered that specify these criteria, however. Assuming, arbitrarily, that loans of $2,000 had been made to 10 percent of the 4.2 million exhaustees of regular UI in calendar year 1983, a total of $840 million in loans would have been issued. Assuming that an interest rate of 7 percent was charged, that interest would begin to accrue six months after the loans were issued, and that quarterly repayments were $150, the present value of the cost of this program to the federal government would have been about $100 million to $150 million. 20/

The actual subsidy provided to recipients could be considerably larger than this cost, however. In the absence of a federal loan or loan guarantee, recipients would have to obtain funds in the private credit market--presum-

19. See Richard B. McKenzie, ed., *A Blueprint for Jobs and Industrial Growth* (Washington, D.C.: The Heritage Foundation, no date).

20. The present value of the federal cost is the total cost if it were all paid in 1983. Actual repayments would have extended through 1987 under the conditions specified in the text. The cost of borrowing to the federal government is assumed to be equal to the three-month Treasury bill rate, which is projected to fall from 9.5 percent in calendar year 1984 to 8.2 percent in calendar year 1987. A default rate on loans of 10 percent is assumed--5 percent when the first payment is due, and 5 percent when the repayment period is half over.

ably at higher interest rates, because of their jobless status and uncertain future income. Thus, the subsidy would depend on the difference between the interest rate in the private market and the rate on the government (or government-guaranteed) loan, in addition to the factors considered above. On the other hand, however, many potential recipients of federal loans might not, or might not be able to, take out loans in the absence of this program.

Proponents argue that loans would satisfy the temporary financial needs of those who exhaust UI benefits, and that they could do so at a lower cost to the UI program. In addition, some maintain that loans would reduce the work disincentives provided by the availability of long-term cash assistance because workers ultimately would bear a greater share of the costs of their aid. Opponents contend that this support would be inadequate, however, and that many recipients would be unable to repay the loans even after becoming reemployed because they would have other debts and might have substantially lower earnings. In addition, such a loan program would represent further federal government interference with private credit markets.

USING UI TO PROVIDE REEMPLOYMENT ASSISTANCE

Options to provide noncash assistance to UI recipients include allowing UI funds to be used directly to promote and assist workers in obtaining reemployment and using UI as a vehicle for providing other types of worker assistance. In particular, proposals considered here would:

- Allow UI funds to be used for retraining and relocation;
- Use UI funds for reemployment vouchers; and
- Create individual training accounts.

Allow UI Funds to be Used for Retraining and Relocation

State UI programs could be allowed more flexibility in helping workers become reemployed by allowing UI funds to be used for retraining and relocation assistance. Under current federal law, state UI funds can not be used for this type of aid.

The Administration's fiscal year 1984 budget submission included a proposal to allow states to use up to two percent of state UI tax receipts for training and job-search assistance for certain dislocated UI recipients. Under CBO's January 1985 economic projections, this proposal would allow states to use up to about $370 million for this aid in fiscal year 1986--an amount considerably larger than the 1985 federal funding level for dislocated worker assistance under Title III of the Job Training Partnership Act (JTPA).

Geographic relocation might be the best option for certain long-term UI recipients whose skills are in demand in other regions of the country. UI benefits can now be transferred from one state to another if the recipient moves, but if jobless workers wait several weeks before deciding to relocate, they might lack the necessary funds. Relocation assistance could include subsidizing both job-search and moving costs. Similar aid is available to a limited group of unemployed persons under the Trade Adjustment Assistance program--which pays 90 percent of reasonable job-search expenses up to $800, 90 percent of reasonable and necessary relocation expenses, and a lump-sum payment of up to $800.

UI recipients whose employment problems derive from skills that are no longer in demand might be assisted by UI-financed retraining. Direct training in a particular skill might be most appropriate for this group of experienced workers, because they already have developed the basic skills and good work habits necessary for successful reemployment. Such aid could promote either vocational training or on-the-job training. The costs of retraining could vary considerably with the type of assistance provided, with vocational training costs of about $2,400 per worker in fiscal year 1986, and on-the-job training costs of about $2,800--assuming that the program would subsidize 30 percent of earnings for six months.

To use whatever funds would be provided most effectively, adjustment services might be sequenced from least expensive to most expensive. As discussed earlier, job-search instruction could be provided to UI recipients not on temporary layoff. Those still without new jobs could then be offered relocation aid. Finally, retraining--the most costly service--might be provided to those workers whose present skills are not in demand either where they now live or in other labor markets. Relocation aid might still be required once retraining was complete.

Most proposals to use UI to aid reemployment would allow workers to apply voluntarily for such assistance. One way of organizing this system would be to set up a two-tier program: the first tier could provide regular

weekly cash UI benefits as under current law; the second tier could provide optional employment and training assistance to certain groups of UI recipients. Groups eligible for the second tier might include so-called dislocated workers or persons who have received more than 13 weeks of benefits, for example.

Some critics of proposals to divert UI funds to training point out that these funds are already allocated for cash assistance and, unless cash benefits were reduced, UI taxes would ultimately have to be increased to pay for this additional aid. Others point out that many jobless workers could not afford to take part in training unless they also received income support, perhaps in the form of continued UI cash benefits. This also points to the fact that UI costs could increase if funds were used for training, rather than having training substitute for weekly cash aid.

Overall, proponents maintain that using UI funds for retraining could help long-term unemployed persons increase their productivity and regain their earnings potential. On the other hand, workers would not be assured of finding permanent employment after completing retraining, and even if they did, the jobs could come at the expense of other workers, thereby simply shifting the burden of unemployment. 21/

Use UI Funds For Reemployment Vouchers

Long-term UI recipients could be allowed the option to transfer part of their benefit entitlements to vouchers payable to new employers. 22/ These vouchers could be redeemable on a portion of the workers' wages over several weeks of employment to ensure that the new jobs were not short-term ones. Making them available only to new employers could limit possible abuses by employers who might otherwise cycle workers through jobless spells to receive the subsidy. The voucher also could be limited to a certain fraction of a firm's total work force.

The value of a voucher could be determined in one of several ways. It could be a multiple of the worker's weekly benefit amount, with that multiple depending on the number of weeks of benefits still remaining to the

---

21. Displacement of other workers is a potential problem in most employment and training programs, however, and is not limited to programs involving UI recipients.

22. As part of its fiscal year 1984 budget proposal, the Administration proposed a voucher for FSC recipients. According to that plan, new employers would have received a tax credit equal to one-half of the worker's weekly FSC benefit for each week of new employment, up to the remaining dollar amount of the FSC entitlement.

jobless worker. For example, if the worker had 10 weeks of UI benefits remaining and was eligible for $125 per week, then the value of the voucher would be $1,250, if workers were given the full remaining entitlement as a voucher, or $625 if only half of the entitlement were transferred to the voucher. Alternatively, the value of the voucher could be set at a fixed dollar amount.

A voucher program could probably be designed to have little additional federal cost, but the net effect on employment would be uncertain. Voucher recipients presumably would already have been unemployed for several months and, if the vouchers were not available, benefit payments probably would otherwise continue to be made to many of them. As long as the subsidy did not simply create unemployment among other workers eligible for UI, program costs would not rise. The subsidy would also reduce employers' business expense deduction for wages, further increasing federal tax revenues.

The net effect of the voucher program on employment would depend on several factors: the extent to which jobs subsidized by the program would have been created in any case, whether the jobs came at the expense of other workers, and whether the jobs lasted beyond the period of the subsidy. Some persons receiving the vouchers might benefit at the expense of other jobless persons either because workers with vouchers would be hired instead of other unemployed persons, or because workers with vouchers would be hired to replace other employees. In addition, because UI recipients often have considerable work experience, they might use vouchers to obtain interim--rather than permanent--employment, later returning to their previous jobs or taking better jobs as they became available.

Proponents of this change maintain that it would be more efficient to use UI funds to promote reemployment in this way than simply compensating jobless persons for remaining out of work. The low added cost compared to some employment and training programs is also an appealing aspect of the voucher program to some. On the other hand, experience with past wage-subsidy programs--most notably the Targeted Jobs Tax Credit--has been mixed, with some indication that relatively small wage subsidies might not be effective in creating additional jobs in the economy.

Create Individual Training Accounts

Another alternative would be to finance retraining through individual training accounts (ITAs) funded by payroll taxes. Different versions of this idea have been formulated either to encourage or to require this form of tax-preferred savings, but several have similar features. Under a typical

plan, the worker and firm would each contribute 0.8 percent of wages--the same rate as the net federal UI tax--up to a limit of $250 annually. These tax payments would continue until the total contributions reached a preset maximum amount--$4,000, for example--but the funds would accrue interest until they were used for allowable retraining. Under some versions of the ITA, the worker could use up to the full account limit even before he and his employer had contributed that amount by borrowing from other persons' accounts. The particular types of training that ITA funds could purchase are often not specified, however. If the worker retired before using the ITA funds, they would be returned to the worker and employer with interest as taxable income, similar to an Individual Retirement Account.

ITA plans often are linked closely to Unemployment Insurance. Under most plans, worker and employer contributions would be either collected as a supplement to the federal UI payroll tax or assessed in a manner similar to that tax. A worker's eligibility to use ITA funds would also be linked to eligibility for UI benefits under some plans. Finally, some ITA plans would use the Unemployment Trust Fund to manage the training accounts and coordinate payments.

If the features of the ITA described above were made mandatory for all workers beginning in fiscal year 1986, the average worker contribution would be about $120, with about 13 percent of workers reaching the $250 annual cap on worker contributions in that year. Combined worker and employer payments could total $25 billion to $30 billion in that year. It would take about nine years for the average worker to accumulate $4,000 in the training account under this version of the ITA (see Table 12), assuming that an interest rate of 8 percent was paid on fund balances and that workers' wages grew at 6 percent annually. A worker earning $5,000 in 1986 would not reach the fund maximum for nearly 17 years, however, while a worker with the maximum combined employee-employer contribution of $500 would reach the limit in about six years.

An alternative version of the ITA would reduce the contributions made by low-income workers by supplementing these payments with federal funds. One example would have the worker contribute one percent of wages, with a cap of $200 annually; the government would pay the difference between the worker's contribution and $200; and the employer would contribute $200 regardless of the worker's wage. Thus, a worker earning $5,000 would pay $50 annually and the government would contribute $150 (see Table 12). Under this plan, it would take each worker seven years to reach the $4,000 account limit, regardless of income. Worker and employer contributions under this version of the ITA could total over $35 billion in fiscal year 1986,

while federal contributions could be about $10 billion. Compared to the first plan above, this alternative would require larger employer contributions for low-wage workers, and could further limit employment in those jobs.

TABLE 12. PROPOSED INDIVIDUAL TRAINING ACCOUNT CONTRIBUTIONS AND TIME UNTIL ACCOUNT LIMIT IS REACHED (In dollars)

Earnings in 1986 a/	Annual Contribution			Years Until $4,000 Balance is Reached b/
	Worker	Employer	Government	
Plan 1: 0.8 Percent Contribution, $250 Maximum c/				
5,000	40	40	0	17
10,000	80	80	0	12
20,000	160	160	0	8
40,000	250 d/	250 d/	0	6
Plan 2: 1.0 Percent Contribution, $200 Maximum, with Federal Support c/				
5,000	50	200	150	7
10,000	100	200	100	7
20,000	200	200	0	7
40,000	200	200	0	7

SOURCE: Congressional Budget Office calculations.

a. Earnings are assumed to grow at 6 percent annually.

b. Assumes interest of 8 percent is paid on account balances.

c. See text for details.

d. $250 cap is reached with $31,250 of earnings.

According to its proponents, an ITA program could have several positive aspects. It could generate large sums of money for retraining, while at the same time have built-in incentives for prudent use because unused funds would be returned, with interest, when the worker retired. In addition, ITA accounts would be portable in that they would be tied to the worker and not the job. Some also argue that ITAs would increase savings and investment, and speed up growth in the economy, although the evidence on similar Individual Retirement Accounts has thus far failed to point to a large net increase in savings resulting from that program.

On the other hand, the payroll tax used to finance this training would increase the cost of labor to employers and could potentially reduce employment--particularly for less-skilled workers--as well as contribute to inflationary pressures. Making employee and employer contributions tax deductible would reduce labor costs, but this program feature also would cause a significant reduction in federal revenues. Some opponents of ITAs also maintain that the need for retraining on this broad a scale has not been established, and that this program is unnecessary; others counter, by noting that ITA funds would be returned to workers and firms if they were not used. The potential effects of ITA funds would also depend, at least in part, on the definition of acceptable retraining--whether, for example, ITA funds only could be used once a worker had permanently lost employment or if retraining could also include personal development or enrichment programs.