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Modernizing the Unemployment Insurance system to better respond to economic downturns

Till von Wachter

TAKEAWAYS

During periods of economic downturn such as during the COVID-19 pandemic, the UI system support is particularly important.

Mandating minimum UI benefits at the federal level could prevent states from reducing benefits to address budget shortfalls.

A federally financed, trigger-based system would ensure smooth and quick UI system expansion during recessions without having to wait for Congress to act.

Expanding the tax base and requiring states to maintain minimal reserves would greatly stabilize funding sources.

Self-employed, contract, and gig workers covered by Pandemic Unemployment Assistance should be included in the regular UI system.

Institute for Research on Poverty
UNIVERSITY OF WISCONSIN–MADISON
irp.wisc.edu

The Unemployment Insurance system (UI) is the largest general social insurance program in the United States for individuals of working age. It is particularly important in times of economic recession such as during the COVID-19 pandemic, since it provides temporary compensation to those who have lost jobs and helps provide economic stability. The UI system has remained largely unchanged since the mid-1970s although the labor market has shifted dramatically; notable changes include deindustrialization, increasing participation by women, growing wage inequality, a rise in independent contracting concentrated in some industries, and technological advancement. Moreover, the UI system has always had lower coverage of minorities, women, and lower income workers. This article describes the current UI system and some suggested reforms to help the UI system better support the current workforce, be more equitable, and be more responsive to economic downturns.[1]

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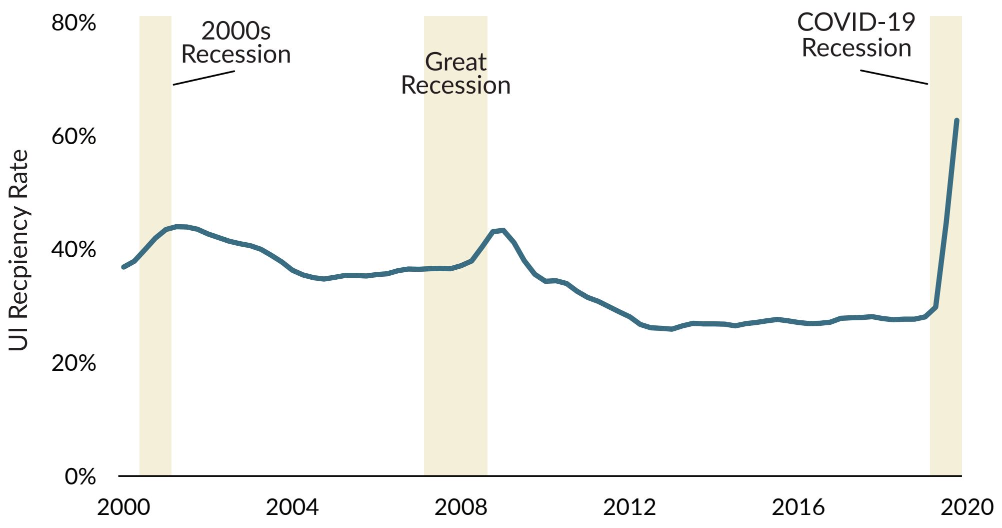
Overview of the UI program

While the U.S. Department of Labor oversees the UI system, it is administered by individual states. The basic program in most states provides up to 26 weeks of benefits to workers who become unemployed through no fault of their own. UI benefits replace about half of their previous wages, up to a maximum benefit amount. Applicants are required to demonstrate a past work history, usually measured by the amount of earnings received over a set period. States typically require earnings above a certain amount in four out of five prior calendar quarters, with thresholds varying across states.

States provide most of the funding and pay for the actual benefits provided to workers; the federal government pays only the administrative costs. Each state may design their own program within the constraints of the federal requirements, and eligibility requirements and benefit terms vary widely across states. In February 2020, prior to the beginning of the COVID-19 recession, average weekly benefits were about $387 nationwide, with a wide range across localities. For example, the weekly average was only $161 in Puerto Rico and $215 in Mississippi, with a high of $550 in Massachusetts.[2] The maximum number of weeks of benefit receipt also varies by state. While many states use the federal maximum of 26 weeks, some states set a lower maximum, such as 13 weeks in Missouri, and 12 to 23 weeks in Florida, depending on the state's unemployment rate. States also have flexibility on the type of work history required for eligibility, so that low-income or younger workers with limited prior earnings may be eligible in some states but not others.

Figure 1. Unemployment Insurance recipiency rates settled at about 25% after the Great Recession but grew to historic heights amid the COVID-19 economic shock and due to temporary policy changes intended to boost uptake.



Sources: UI Recipiency: US Department of Labor, Unemployment Insurance Data. 2000-2020. https://oui.doleta.gov/unemploy/data_summary/DataSum.asp. Recession Data: National Bureau of Economic Research: https://fred.stlouisfed.org/series/USRECQ.

Notes: Recipiency rates are the average of each quarter and preceding three quarters to smooth seasonal variation in UI recipiency trends. UI Recipiency peaked at 98% in Quarter 3 of 2020.

Program financing

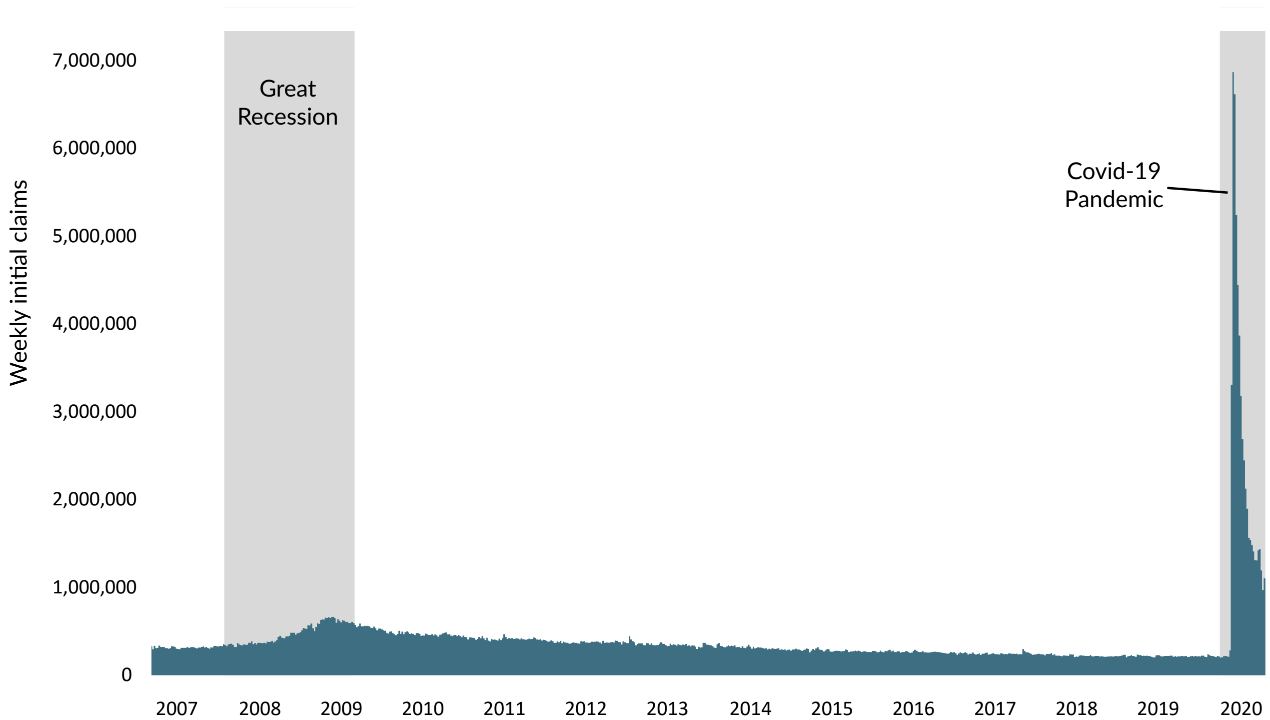
While states may set their own financing structure, nearly all choose to fund their programs through employer payroll taxes. In good economic times, states build up rainy day "trust funds" to protect against future economic downturns. When recessions occur, states dip into their trust funds and, in a severe recession, may need to borrow money from the federal government to make up the shortfall. After the Great Recession of 2007–2009, states had to rebuild their trust funds by either raising taxes or reducing benefit amounts. Faced with this choice, many states reduced benefits by, for example, lowering maximum duration to as low as 13 weeks, or by tightening eligibility restrictions. As a result, as shown in Figure 1, just over 1 in 4 unemployed individuals was actually receiving UI benefits in 2018, shortly before the COVID-19 recession began.

COVID-19 led to a rise in the number of UI claims among more vulnerable workers, including women, minorities, less educated, and younger workers losing jobs in accommodation and food and retail sales industries, among others.

UI and COVID-19

The COVID-19 recession caused a steep increase in new applications for UI benefits. As shown in Figure 2, this spike greatly exceeded any from prior economic downturns, including the Great Recession. COVID-19 also led to a rise in the number of UI claims among more vulnerable workers

Figure 2: Weekly unemployment claims spiked dramatically during the COVID-19 pandemic.



Sources: Unemployment initial claims: U.S. Department of Labor, Office of Unemployment Insurance. Weekly Claims Data. https://oui.doleta.gov/unemploy/claims_arch.asp. Retrieved 14 September 2020. Recession data: National Bureau of Economic Research, US Business Cycle Expansions and Contractions. https://www.nber.org/cycles.html. Retrieved 14 September 2020.

including women, minorities, less educated, and younger workers losing jobs in accommodation and food and retail sales industries, among others.[3]

The Extended Benefits Program, established in 1970, is activated by national and state unemployment rates reaching a certain "trigger" threshold and provides from 13 to 20 additional weeks of UI benefits. However, half of these benefits must be paid by the states, which also typically experience financial shortfalls during recessions. Congress can authorize the federal government to pay all Extended Benefits or authorize federally funded Emergency Unemployment Compensation, as happened during the Great Recession.

Aside from any designed trigger response, expansion of UI access, benefit amount, and duration during an economic downturn requires legislation. In response to the spike in unemployment resulting from COVID-19, the federal government enacted a number of expansions, including increasing the dollar amount of benefits (an additional $600 per week for four months in the spring and summer of 2020, then an additional $300 per week for some claimants during August-September, followed by $300 for all claimants beginning in late December 2020), extending the maximum number of weeks that benefits can be received (first adding 13 weeks, then an additional 11 weeks), and funding the Pandemic Unemployment Assistance program for the self-employed, independent contractors, and those with short work histories who otherwise would not be eligible for benefits (see Figure 3).

Effects of UI on workers and employers

Economists have long been concerned that UI may lead unemployed workers to stay out of the labor market for longer than they would have in the absence of benefits. Indeed, evidence suggests that both higher benefit amounts and longer maximum receipt periods are associated with longer periods of time out of the workforce for those receiving benefits.[4] While research on this question is ongoing, it appears likely that there are behavioral consequences that should be taken into account when considering potential system reforms.

Much research has focused on determining the appropriate amount and duration of UI benefits, given the potential tradeoff between providing unemployed individuals with sufficient support and reducing the incentive to return to work. Current estimates suggest that benefit amounts equal to half of prior wages and durations of 26 weeks or less may be less than optimal.[5] This work also suggests that during recessions, UI benefit levels should be higher and should be available for longer periods of time.

Employers potentially also respond to the system. In particular, firms releasing many workers into UI will see increased UI taxes (a system called experience rating). This may lead some firms to refrain from using the system or give them an incentive to question their employees' UI claims. A broader concern is that many firms may not think of the system as a resource, contributing to the low rates of uptake of UI among their employees.

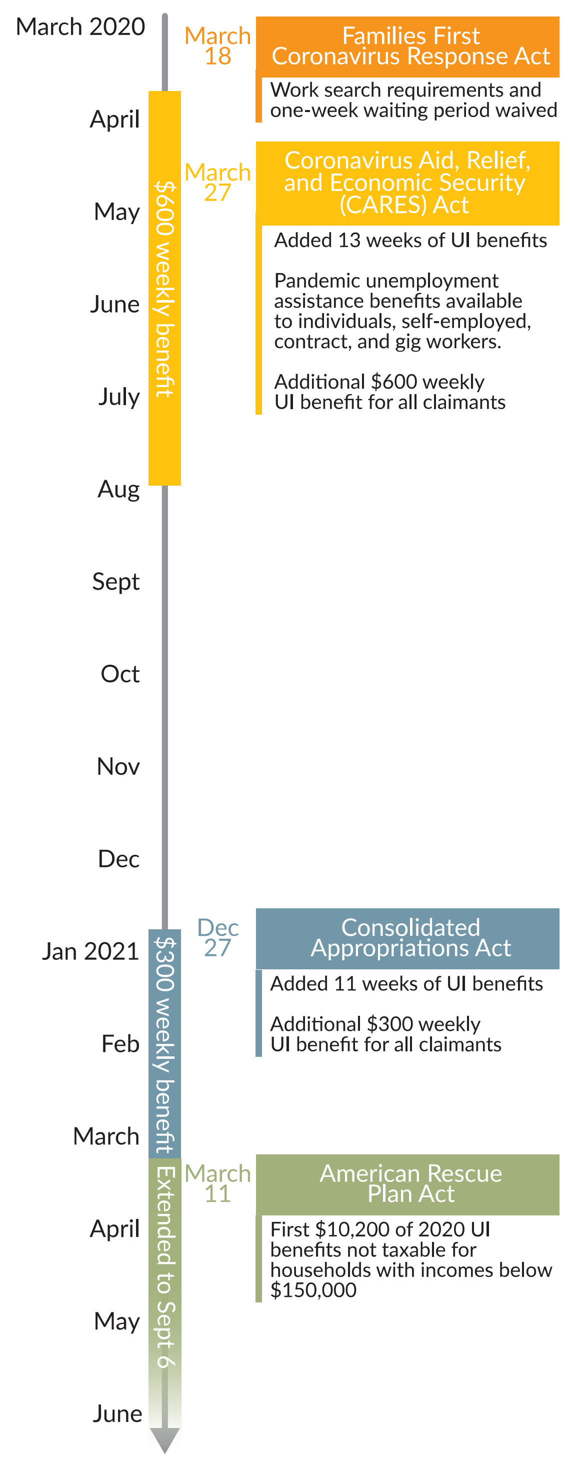
Potential reforms to UI

There are many ways that the UI system could be improved while retaining the central principles of the current system. In particular, there are several potential reforms that would make UI more responsive in times of recession, such as that resulting from the COVID-19 pandemic.

Mandate minimum benefits

Prior to the COVID-19 pandemic, and in part to address financial issues in the wake of the Great Recession, several states reduced maximum benefit durations below the typical 26-week length. There is considerable variation among states in both maximum duration and benefit amount but no compelling reason why workers in different states should face different levels of benefit generosity. The federal government should mandate a minimum potential duration of benefits of 26 weeks, and an average benefit level of 50% of prior wages. Benefit amounts should also include an allowance to provide additional support to families with dependent children and for low-wage workers who could not support a family based on 50% of their earnings.

Figure 3. Federal COVID-19 pandemic relief legislation: Primary unemployment benefit provisions.



Improve UI response to recessions

UI provides critical support to workers in times of recession. Experiences of both the aftermath of the Great Recession and the COVID-19 pandemic demonstrate that relying on the political process to extend UI benefits in times of economic downturn can lead to gaps in coverage for affected workers. Thus, the current Emergency Unemployment Compensation program, which requires an act of Congress to implement, should be replaced with a federally financed trigger-based program.[6]

Only 25% of U.S. earnings covered by UI laws are currently subject to state UI payroll taxes, a consequence of growing wages and low taxable wage bases that are not set to increase as average wages rise. The minimum taxable wage base, set by the federal government, has remained at $7,000 since 1983. While most states have set a wage base that exceeds the federal minimum, most are relatively low—$15,000 or less—and some states, such as California and Florida, continue to use the $7,000 federal minimum.[7] Many states' UI tax rates have remained low as well. As a result, many states have trust funds that are inadequate to withstand a recession, and thus have increasingly had to resort to borrowing in order to pay UI benefits during periods of economic downturn. To address this, the minimum taxable wage base should be expanded, and states should be required to hold minimum reserves to cover UI benefits during a recession without depleting the state trust fund.

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Serve a broader group of workers

The COVID-19 pandemic has suggested that at least in large economic downturns, there is a need to provide income insurance to those workers currently not eligible for benefits. A large share of potentially unemployed workers is not covered by the standard UI system. This is in part due to changes in the structure of the workforce in recent decades, with rising part-time employment, especially among women, and increasing numbers of self-employed, contract, and gig workers. In addition, the UI system has always had lower coverage of minorities, women, and lower income workers.[8] The Pandemic Unemployment Assistance program did extend benefits to more workers, but this is not part of the regular UI system. The increase in contract workers in certain industries means that more and more lower- to middle-income workers are at risk of being excluded from the UI system.

While some states have made benefits available to larger groups of workers, there is great variation in UI eligibility. Eligibility standards should be more uniform across states. Reforms to achieve this should include those proposed in the American Recovery and Reinvestment Act of 2009, such as allowing for UI beneficiaries to receive job training, allowing part-time workers to claim benefits, enhancing the mobility of working couples by making workers who leave a job for a family-related move eligible for UI, and using an alternative base period to raise eligibility among workers with lower or unstable earnings that meet federal guidelines. Policymakers should consider ways to extend UI coverage to these workers, possibly drawing on how self-employed workers contribute to Social Security and Medicare.

Improve program operations and effectiveness

States must collect data on workers' wages, UI benefit amounts, and employers' UI taxes in order to maintain daily operations of their UI programs. However, little of this data is shared with federal agencies and thus not readily available to researchers. Establishing a national data collection system would both improve program operations and permit researchers to collect and evaluate evidence on UI effectiveness. These changes should be supported by providing states with common software and funding for hardware upgrades. Data collection reforms should also establish protocols to allow safe and secure access to the data for research purposes and as a feedback loop for UI system improvements.

Other reforms

Modernize UI technology systems

Most states use outdated technology systems to administer UI claims.[9] These systems made it very challenging for states to efficiently provide unemployment benefits to workers during the pandemic. In particular, the Pandemic Unemployment Assistance program—which extended benefits to self-employed, contract, and gig workers—was very difficult for states to implement quickly because of the different types of documentation needed for these workers to verify their incomes.[10] Modernizing these technology systems would help states administer currently-eligible claims and to adapt to future expansions of the UI system. Such modernization would also aim at increasing the rate of UI benefit receipt, especially among more vulnerable workers who may have difficulty accessing online platforms. The system should also routinely generate data that would allow monitoring of how equitable access to UI is across demographic groups, regions, and states.

Reform firms' UI tax rates

The current UI tax structure subsidizes more volatile industries such as construction, manufacturing, and mining.[11] This is because firms' UI use is not fully reflected in their payroll tax rates. Research suggests that if UI taxes would fully reflect firms' layoff histories it would encourage employers to reduce the number of layoffs during recessions and result in stable hiring during economic expansions.[12] At the same time, high tax rates can encourage firms to fight their workers' UI claims, something that could particularly affect already vulnerable workers. Any serious efforts towards UI reform must incorporate how firms interact with the UI system, and how this differs across employers.

Add a "job seeker allowance"

UI applicants must generally meet certain past earnings or work history levels in order to receive benefits. As such, unemployed individuals with limited work history may not qualify for traditional UI benefits. Adding a job seeker allowance could provide short-term assistance to these workers and help to improve job outcomes.[13]

Proposals for innovation

While the reforms described above would modernize the UI system and help make it more responsive during periods of economic downturn, the system as currently designed cannot prevent or protect against large and long-term earnings losses resulting from layoffs. Below are two potential innovations of the existing system that could greatly expand its reach without creating an entirely new program.

Institute a work sharing system

States have increasingly instituted work sharing programs allowing workers to receive prorated UI benefits while remaining employed as an alternative to layoff. Evidence from other countries suggests that work sharing can greatly reduce layoffs and allow employers to retain their employees even during periods of economic downturn. However, few employers in the United States have made use of these programs, in part due to lack of awareness of the option, and to restrictive program rules. Unlike with other special programs in the UI system, there is also currently no experimental evaluation of the effects of work sharing programs. Policymakers should consider expanding the current work sharing options to increase the number of participating states and employers and institute a comprehensive formal evaluation of different aspects of the program.

Experiment with wage insurance

Since UI insures only a fraction of the total potential earnings loss of those who become unemployed, it can only partially act as an insurance mechanism and automatic stabilizer during recessions. A number of researchers suggest complementing the current UI system with wage insurance. Such a program would make up part of the gap between wages at the time of layoff and current wages and would thus help reintegrate the long-term unemployed into the labor market, even at a lower wage. A closely related approach is paying reemployment bonuses to workers who exit UI, something promoted by several states during the COVID-19 pandemic. By speeding up reentry, this could provide a cost savings by lowering UI payments. The existing literature does suggest that similar programs can raise job-finding rates and be cost effective when targeted appropriately.[14] Wage insurance is a policy tool that is certainly worth additional research and an experimental evaluation to assess its impacts.

Policy implications and future research

Several of the reforms described here would be particularly useful in making the UI system more responsive during economic downturns—especially during those as extensive as the COVID-19 recession. These include mandating minimum UI benefits at the federal level to prevent states from reducing benefits to address budget shortfalls; instituting a federally financed, trigger-based system to ensure that the UI system can be quickly and smoothly expanded on a temporary basis during recessions; stabilizing funding by expanding the tax base and requiring states to maintain minimal reserves; and increasing the proportion of unemployed workers who are covered by the system. All but the last of these are supported by research evidence, longstanding regulatory experience, or both. More U.S.-based evidence is also needed on the potential for a system of work sharing or wage insurance to prevent significant long-term earnings reductions associated with job loss. Overall, UI has shown itself to be a crucial program for American workers that is worthy of being modernized and strengthened through appropriate reforms.■

Till von Wachter is Professor of Economics at the University of California, Los Angeles.

[1]This article draws on: von Wachter, T. (2019). Unemployment Insurance Reform. *The ANNALS of the American Academy of Political and Social Science*, 686(1), 121–146. https://doi.org/10.1177/0002716219885339

[2]Center on Budget and Policy Priorities. (2021). *Policy Basics: Unemployment Insurance*. https://www.cbpp.org/research/economy/unemployment-insurance

[3]See: Bell, A., Hedin, T.J., Moghadam, R., Schnorr, G., von Wachter, T. (2021). *An Analysis of Unemployment Insurance Claims in California During the COVID-19 Pandemic*. California Policy Lab, University of California, Los Angeles.

[4]See, for example: Schmieder, J. F., and von Wachter, T. (2016). The effects of unemployment insurance benefits: New evidence and interpretation. *Annual Economic Review*, 8, 547–81.

[5]See, for example: Chetty, R. (2008). Moral hazard versus liquidity and optimal unemployment insurance. *Journal of Political Economy*, 11 (2), 173–234.

[6]For a discussion of the current system of triggers and an example of a design problem and a reform proposal, see Bell, A., Hedin, T.J., Schnorr, G., von Wachter, T.. 2021. *Why Extended UI Benefits were Turned Off Prematurely for Workers in 33 States*. California Policy Lab, University of California Los Angeles.

[7]The other states or U.S. territories that use a $7,000 taxable wage base are Arizona, Puerto Rico, and Tennessee; see https://www.apspayroll.com/resources/payroll-taxes-rates-and-changes/suta-wage-bases/.

[8]See: Bell, A., Hedin, T.J., Moghadam, R., Schnorr, G., von Wachter, T. (2021). *As Crisis Continues, More Unemployed Californians are Receiving UI Benefits*. California Policy Lab, University of California Los Angeles.

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