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INTRODUCTION TO UNEMPLOYMENT INSURANCE

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The federal-state unemployment insurance system helps people who have lost their jobs by temporarily replacing part of their wages. Created in 1935, the system is a form of social insurance, with contributions being paid into the system on behalf of working people so that they have income support if they lose their jobs. The system also helps sustain consumer demand during economic downturns, by providing a continuing stream of dollars for families to spend.

The basic unemployment insurance program is run by the states, although it is overseen by the U.S. Department of Labor. States provide most of the funding, and pay for the actual benefits provided to workers; the federal government pays only for the administrative costs to the states of running the program. Although subject to a few federal requirements, states are generally able to set their own eligibility criteria and benefit levels.

The basic state-funded program typically provides up to 26 weeks of benefits to unemployed workers, and replaces on average 38 percent of their previous wages. There is also an extended benefits (EB) program, which is funded half by the federal government and half by state governments. This permanent program provides an additional 13 or 20 weeks of benefits to jobless workers in states where the unemployment situation has worsened dramatically, regardless of whether the national economy is in recession.

In addition, during and just after recessions, when jobs are scarce and many people are out of work for long periods of time, the federal government has historically provided funding for additional weeks of benefits in *all* states. The most recent federal program, called Temporary Emergency Unemployment Compensation (TEUC), was enacted in March 2002, and provided 13 extra weeks to all workers, and 26 weeks in very high unemployment states. The TEUC program is currently scheduled to start phasing out at the end of 2003. A handful of states also have additional benefit programs of their own.

The following analysis discusses:

- who is eligible for unemployment insurance;
- what kind of benefits are provided;
- what additional benefits are available during economic downturns;
- how unemployment insurance is funded; and
- whether unemployment insurance stimulates the economy.

Who Is Eligible for Unemployment Insurance?

There are three basic criteria that a person must meet in order to qualify for unemployment insurance benefits:

(1) the person must have lost a job through no fault of his or her own;

(2) the person must be ready, willing and able to take a “suitable” new job; and

(3) the person must have earned at least a certain amount of money during a recent one-year time period (usually referred to as the “base period,” this is generally the first four of the last five completed calendar quarters at the time the person files for benefits).

There is considerable variation among the states in how they apply each of these general criteria, however. For example, many states do not cover part-time workers unless they are willing to take a full-time job; other states allow these workers to qualify even if they are seeking another part-time job. Also, some states set the “base period” as the four quarters immediately prior to the unemployment insurance claim, which allows a worker’s most recent earnings to be taken into consideration. This particularly helps people with relatively brief or intermittent work histories, such as women who have recently left welfare for work.

Many unemployed workers do not actually qualify for unemployment insurance benefits. One of the principal reasons is that some states have restrictive earnings or other requirements that make it difficult for some workers to qualify, particularly low-wage workers. In addition, the system is designed so that certain groups of unemployed workers do not qualify for benefits at all. They include new entrants to the workforce (such as recent high school or college graduates), as well as most people who have only recently reentered the workforce. Also by design but more controversially, several other groups of workers do not qualify for unemployment insurance benefits. These include certain domestic and agricultural workers who are excluded from the system altogether; people who choose to leave their jobs for reasons not under their control, such as needing to follow a spouse to a different geographical location or child care arrangements falling apart; and, as noted above, many part-time or recently hired workers.

What Kind of Benefits Does Unemployment Insurance Provide?

When an unemployed worker applies for benefits — typically over the phone or the Internet — the state must determine not only whether the person is eligible, but also for what level of benefits the person qualifies. The benefits provided to any particular individual will vary in two respects: the number of weeks that they last, and how much they are worth.

Number of weeks of benefits: While some states simply provide the same number of weeks of benefits to all unemployed workers, in most states the number of weeks available is determined by: the amount of past earnings; whether there were earnings in each of the four quarters in the base period; and how evenly those earnings were distributed over the base period.

In most states, workers are eligible for a maximum of 26 weeks, although about 35 percent of workers qualify for less than the full 26 weeks, because of uneven earnings or a brief work history. In two states — Massachusetts and Washington — workers can receive up to 30 weeks of benefits from the state. Of course, many workers find new jobs before they run out of benefits, and end up not needing the full 26 (or 30) weeks.

Dollar amount of benefits: The average unemployment benefit is $258 per week. However, individual benefit levels vary greatly, and depend on what state the person lives in and what he or she was previously earning. On average, benefits replace 38 percent of an unemployed worker's previous earnings, although the replacement rate ranges, typically from 25 to 55 percent, with low-wage workers generally at the higher end of that range. In addition, in several states, workers receive higher benefits if they have dependents. In 2002, the maximum benefit available to workers ranged from a low of $205 in Arizona to a high of $507 ($760 with dependents) in Massachusetts. Unemployment insurance benefits are subject to federal income taxes, just as any other working person's income would be.

What Additional Benefits Are Available During Economic Downturns?

There are three types of programs that provide extra weeks of benefits to workers in states where unemployment has increased significantly: (1) the permanent federal-state Extended Benefits program, which is available to hard-hit states even when the national economy is not performing poorly; (2) a temporary federal program that is generally put in place during national economic downturns; and (3) additional temporary or permanent programs that states sometimes choose to put in place.

The permanent federal-state *Extended Benefits (EB)* program was first enacted in 1970 and then cut back substantially in 1981. This program provides up to 13 weeks (or 20 weeks, in extremely high unemployment states) of extra benefits for workers who have exhausted their 26 weeks of state benefits, and is funded half by state and half by federal dollars. There are three unemployment rate "triggers" in the EB program that determine whether a state qualifies for benefits. One trigger is mandated by federal law, and the other two are optional triggers that apply only if a state passes legislation to that effect. The benefits are administered by the state — the worker does not have to apply to a different office — and the dollar amount is the same as under the basic state program.

Few states are helped by the EB program, however. In the current downturn, only six states have ever qualified — Alaska, Idaho, Michigan, North Carolina, Oregon, and Washington. A primary reason is that the mandatory trigger is set extremely high, and effectively requires many states to reach at least an eight percent unemployment rate in order to qualify.[1] In addition, most states have not adopted the optional triggers, which are set somewhat lower than the mandatory trigger, although they are still too high to help many states.

[1] The Center on Budget and Policy Priorities has estimated that an eight percent total unemployment rate is equivalent to the rate that is actually specified in the EB statute, which is a five percent "insured unemployment rate." The insured unemployment rate measures the unemployment level among people qualified to receive unemployment insurance benefits, whereas the total unemployment rate — the more common and better known measure — denotes the level of unemployment among the entire population.

Unemployment Insurance Benefits
Currently Available to Jobless Workers

Worker loses Job →	**Regular unemployment insurance** state-funded typically provides up to 26 weeks of benefits	*if still unemployed →*	**Temporary Emergency Unemployment Compensation (TEUC)** federally-funded provides up to 13 weeks of benefits in most states, 26 weeks in a few high unemployment states starts phasing out at the end of 2003	*if still unemployed* *<u>and</u>* *living in one of the few states that meets a high unemployment trigger →*	**Extended Benefits program (EB)** half federal, half state-funded provides up to 13 weeks of benefits, 20 in exceptionally high unemployment states	*if still unemployed* *<u>and</u>* *living in a state that has set up a program →*	**State-funded additional benefits** state-funded number of weeks varies by state

In part due to these flaws in the EB program, in each of the past five recessions, Congress has created a temporary federal benefit program to supplement the EB program. The current temporary program, enacted in March 2002, is called the *Temporary Emergency Unemployment Compensation (TEUC)* program. It provides up to 13 weeks of additional benefits to workers in all states, with up to 26 weeks of TEUC benefits available to states that have either triggered onto the EB program or that meet an unemployment rate trigger that is similar to, but somewhat lower than the mandatory trigger in the EB program. (As a result, workers in the three states that now meet one of these triggers get, on top of their 26 weeks of regular state benefits, 26 weeks of TEUC benefits plus 13 weeks of EB benefits.) TEUC benefits are financed entirely by the federal Unemployment Trust Funds.

The TEUC program is currently set to start phasing out at the end of 2003. Starting in 2004, no new workers will be added to the TEUC program. Those who have already begun receiving some TEUC benefits, however, will be allowed to continue on and receive the remaining number of weeks of benefits for which they are eligible.

Finally, some states have elected to use their own funds to provide additional weeks of benefits to jobless workers who exhaust TEUC (and, in some cases, EB) benefits. As of October 2003, three states were providing additional temporary benefits: Kansas, New Hampshire, and Utah. Several other states had temporary programs in effect earlier in the current downturn, but those programs have since lapsed. Some states also have permanent additional benefit programs, but few if any of them are currently in effect, generally because of flawed triggers or inadequate funds.

How Is Unemployment Insurance Funded?

The unemployment insurance system is funded by taxes paid by employers on behalf of their employees. Most of these taxes are collected by state governments, but some are collected by the federal government. While both the federal and state taxes are technically paid by employers (although in a few states, the employee pays part of the state tax), economists generally regard the tax as falling on employees. The theory behind this is that the dollars employers use to pay the tax are part of overall compensation costs, and would otherwise have gone into employees' paychecks.

The federal tax is set by the Federal Unemployment Tax Act (FUTA), and is equal to 0.8 percent of the first $7,000 paid annually to each employee. This tax is regressive; since most workers earn more than $7,000 per year, most workers are effectively paying the same flat tax of $56 per year regardless of income. The percentage of overall wages paid in FUTA taxes on behalf of high-wage workers is therefore much lower than for low-wage workers.

The revenues raised by the federal tax flow into the federal Unemployment Trust Funds, which contained approximately $20 billion as of September 30, 2003. These funds are maintained in four accounts, each of which has a specific purpose: (1) financing the administrative costs to the states of providing unemployment benefits and offering job location and information services; (2) paying the federal share of the Extended Benefits program; (3) making occasional loans to state unemployment programs that run short of funds; and (4) providing benefits to former federal employees. In addition, Congress can draw on the balances in the federal trust funds to pay for additional temporary federal benefits during recessions. Also, when federal trust fund balances reach a certain high level, additional transfers are automatically made to the states. These are known as "Reed Act" transfers (named after the 1954 legislation establishing this policy), and they go directly into state unemployment trust funds. While states cannot transfer this money out of their trust funds for purposes other than unemployment insurance, they are not required to use it to improve or expand their unemployment insurance benefits.

States generate funding for unemployment insurance through a tax on employers as well. The amount of earnings subject to the tax varies, but in most states, it is less than $10,000. (Due to the caps on taxable earnings, the state unemployment insurance tax is, like the federal tax, regressive.) The tax rate applied to these earnings varies not only by state but also by industry; employers in industries with high turnover (and therefore a greater likelihood that their employees will apply for unemployment benefits at some point) are generally taxed at a higher rate. In 2002, the average rate applied to *taxable* earnings was 1.8 percent, which was equivalent to an overall tax of only 0.5 percent of *total* earnings. These revenues flow into state unemployment trust funds, and are used to pay the actual benefits that workers receive under the regular state program, as well as the state share of benefits under the Extended Benefits program.

Does Unemployment Insurance Stimulate the Economy?

In addition to the benefits conferred on individual workers, economists believe that unemployment insurance has a stabilizing and stimulative effect on the economy during recessionary periods. This is because the benefits go to people who are very likely to spend them (and might not be spending money if they did not have this source of income). This puts these dollars in circulation and helps to boost consumer demand, and in turn, production and job growth. In fact, the economic stimulus effects of unemployment insurance were a major part of the reason Congress created the program during the Great Depression.

Recent research has sought to quantify the positive effects that unemployment insurance benefits have on the economy. A 2003 study by Economy.com evaluated various stimulus options and found that unemployment insurance benefits were the single best mechanism under consideration for boosting the economy. Specifically, the study found that each dollar of federal benefits provides a $1.73 jolt to the economy. A 1999 study commissioned by the U.S. Department of Labor found an even larger effect, with each dollar of unemployment insurance benefits generating $2.15 in gross domestic product.

The fact that the unemployment insurance system does not help all unemployed workers limits its effectiveness as economic stimulus, however. Many unemployed workers do not qualify for benefits at all, either because they never had a job in the first place, or because they do not meet the program's eligibility criteria. Also, during difficult economic times, many workers who do qualify for unemployment insurance end up exhausting all their benefits before finding work. These workers are generally left without any dollars to spend to help gear up the economy.