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ADDRESSING LONGSTANDING GAPS IN UNEMPLOYMENT INSURANCE COVERAGE

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Unemployment Insurance (UI) is a joint federal-state program designed to provide temporary income support to workers who have a demonstrated attachment to the labor force and lose their jobs due to a lay-off or for other economic reasons, or who must leave their jobs through no fault of their own. (See the box on page 2 for an overview of the UI system.) Unfortunately, the UI system is not performing as well as it should in meeting this goal. Many workers who lose their jobs — especially low-income and part-time workers — end up not receiving any unemployment benefits; many others exhaust their benefits before finding a new job.

The need to modernize UI has been evident for some time, and many states have made progress reforming their UI laws over the past decade or so. It is time for the federal government to lend its support and encouragement to these efforts, and legislation to achieve such reform has recently been introduced in both the House and Senate.

The UI Program Needs Modernizing

UI was designed in the 1930s, at a time when the majority of the workforce consisted of married men who were the sole breadwinners for their family, and the UI system has been slow to adapt to the changing demographics of the labor force. The sharp rise since the 1930s in women's labor force participation and the growing prevalence of two-earner couples and single working parents is not reflected in many states' UI eligibility criteria, which often fail to take into account the impact that family considerations — such as the need to care for a sick child or the collapse of child-care

KEY FINDINGS

- The share of unemployed workers receiving unemployment insurance has declined in recent decades and now stands at just 37 percent. This is a sign that the UI program, designed in the 1930s, does not reflect the realities of work and family life today. Many workers who lose their jobs receive no UI benefits; others exhaust their benefits before finding a new job.
- Now is an opportune time for UI reform. Renewing the Federal Unemployment Tax Act surtax scheduled to expire this year (as President Bush has proposed) would provide about \$7 billion over five years that could be used to encourage states to institute UI reforms.
- Legislation introduced in the House and Senate (H.R. 2233 and S. 1871) would use these funds to give states financial incentives to extend coverage to more low-wage and part-time workers (who are often women), people in extended training programs for high-demand occupations, and those whose job loss was due to compelling family circumstances (such as domestic violence or a family member's illness).
- In addition to addressing gaps in coverage due to outdated eligibility criteria, the current UI extended benefit program needs to be reformed to better serve the needs of the long-term unemployed.

arrangements — can have on women’s employment histories. The entry of more low-income single mothers into the labor force as a result of welfare reform, expansions in the Earned Income Tax Credit, and other factors lend further importance to these considerations. In most states, workers who lose employment for such a reason and are trying to find a new job are denied unemployment benefits.

Problems also have arisen regarding the treatment of workers who remain unemployed for extended periods of time and exhaust their regular unemployment benefits, which normally last no more than 26 weeks. Exhaustion is especially prevalent during economic downturns, when labor markets are weak and job opportunities are scarce. Since 1970, the UI system has had an “extended benefits” (EB) program to provide additional weeks of benefits when a state is experiencing widespread unemployment. However, federal and state policy changes in the early 1980s made the EB program largely ineffective, even during recessions, by making the criteria for determining when “extended benefits” are triggered in a state overly restrictive.

The inadequacy of UI in dealing with prolonged unemployment is evidenced by the fact that in every economic downturn from 1958 to the present — both before and after the enactment of the EB program — Congress has seen the need to enact a *temporary* federal extended unemployment benefits programs. By the time these temporary federal programs have been enacted, however, many jobless workers have suffered hardship in the recessions’ early stages.

An Overview of the UI System ^a

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 they have income support if they lose their jobs. In addition, research has found that dollar for dollar, the income support from UI is a particularly effective “automatic stabilizer” for the economy as a whole, cushioning the impact of rising unemployment on consumer spending during economic downturns.

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 that states incur in running the program. (UI tax receipts and expenditures are, however, recorded as federal revenues and expenditures in the federal budget.) 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 most states’ benefit formulas specify a replacement rate of 50 percent or more of a worker’s previous wages, with a cap on the maximum benefit.^b There is also an extended benefits (EB) program, which is funded half by the federal government and half by state governments and which “triggers on” under certain, very limited conditions. The extended benefits program provides an additional 13 weeks of benefits (and up to 20 weeks in some states) to jobless workers in states where the unemployment situation has worsened dramatically. In times of national recession, Congress also typically enacts a fully federally-funded, temporary extension of unemployment benefits.

^a For more information, see Martha Coven, “Introduction to Unemployment Insurance,” Center on Budget and Policy Priorities, revised November 10, 2003, <http://www.cbpp.org/12-19-02ui.htm>.

^b For workers subject to the benefit cap, the actual replacement rate is lower than the statutory rate. There are no regularly reported data on replacement rates. A figure often cited as the “replacement rate” is the Department of Labor’s calculation of the average weekly benefit received by UI recipients as a percentage of the average weekly wage of all covered workers. That figure, which was 36.3 percent in the first quarter of 2007, appears to significantly understate the true replacement rates of workers actually receiving UI.

In addition to hardships caused by the delayed introduction of temporary extended benefits, each of the last two recessions (in 1990-91 and in 2001) has been followed by a long “jobless recovery” in which the unemployment rate rose even after the official “end” of the recession, long-term unemployment persisted, and the percentage of jobless workers who ran out of benefits before finding a job remained high. The latest temporary extended benefits program was allowed to lapse at the end of 2003, even though long-term unemployment and UI exhaustion rates were still high at that time.

This Is an Opportune Time to Institute Reforms

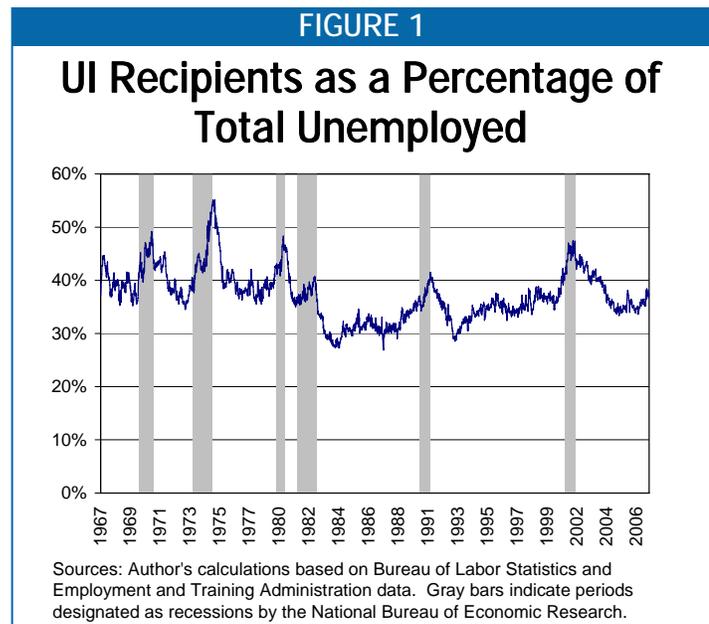
The U.S. economy is not currently in a recession, and there is no immediate crisis placing excessive pressure on the UI system’s resources. But the need for reform of the system is clear.

Moreover, this is an auspicious time for reform. As a start, renewing the Federal Unemployment Tax Act (FUTA) surtax scheduled to expire this year would provide about \$7 billion over the period 2008-12 that could be used to encourage states to institute UI reforms that are long overdue. Reforms that would aid workers who fall through the cracks in the current system would not only benefit such workers and their families today, but would also strengthen the income-support and automatic-stabilizer roles of unemployment insurance when the next recession hits.

Addressing Gaps in Coverage

Only about 37 percent of unemployed workers (or 2.5 million people) were receiving unemployment insurance benefits in June 2007.¹ In contrast, 42 percent of unemployed workers were receiving benefits in March 2001, when the previous recovery peaked. This decrease in the percentage of unemployed workers receiving unemployment benefits likely reflects in part the increase in the percentage of unemployed workers who are *long-term* unemployed (i.e., out of work for more than half a year and still looking for a job; see the box on page 4). It also may reflect an increase in the percentage of unemployed workers who do not qualify for unemployment insurance benefits under overly restrictive state eligibility criteria.

To be sure, unemployment insurance was not designed to cover all unemployed workers. Voluntary job leavers who are looking for other work,



¹ The number of people who receive unemployment insurance benefits at some point over the course of a year is larger than the number who are receiving it at any point in time. About 7½ to 8 million people receive UI at some point during the year.

people looking for their first job, and re-entrants who previously left the labor force voluntarily are not covered. The program's goal has been to provide temporary assistance to workers who lose their jobs through no fault of their own. However, the percentage of unemployed workers who meet that criterion but nevertheless fail to satisfy the program's eligibility criteria, which are increasingly out of date and inconsistent with current labor-market conditions and realities, is significantly higher than it should be if the program is to fulfill its mission.

Such a conclusion is widely shared. More than a decade ago, the bi-partisan, blue-ribbon Advisory Council on Unemployment Compensation (ACUC), appointed by the President and Congressional leaders and headed by esteemed former Bureau of Labor Statistics Commissioner Janet Norwood, identified a number of serious problems with UI eligibility and other rules. The Commission made a series of important recommendations for modernizing the UI system.² Some states subsequently instituted some of the suggested reforms, but no comprehensive effort was ever made at the federal level to consider the panel's recommendations and act upon them. On average, the percentage of

Current Labor Market Conditions

The national unemployment rate stood at 4.6 percent in July 2007. This is lower than the most recent peak of 6.3 percent reached in June 2003, but it is somewhat higher than the 4.3 percent rate in March 2001, when the previous recovery ended and the last recession began. (It is significantly higher than the 4.0 percent annual rate achieved in 2000.)

Some 7.1 million workers were unemployed in July 2007, up from 6.1 million in March 2001, and further declines in unemployment are unlikely. Despite some concerns about recent softness in the economy, forecasters are not predicting an imminent recession. They do, however, expect the unemployment rate to edge up closer to 5 percent over the next year or so.^a

Some other labor-market indicators are not quite as favorable as the unemployment rate is and suggest that conditions for finding a job may be somewhat more difficult than the unemployment rate would imply. The "labor force participation rate" — the percentage of the civilian non-institutional population aged 16 and over that is either working or actively looking for work — stood at 66.1 percent in July 2007, which is 1.1 percentage points lower than the rate in March 2001, when the previous economic recovery peaked. Similarly, the employment-to-population ratio — the percentage of the civilian non-institutional population aged 16 and over that is employed — stood at 63.0 percent in July 2007, 1.3 percentage points lower than in March 2001.

Long-term unemployment is another indicator that suggests the current labor market is not as robust as it was before the start of the 2001 recession. In July 2007, 1.3 million people had been unemployed for 27 weeks or more and hence were beyond the standard eligibility period for regular unemployment insurance benefits. That compares with just 696,000 long-term unemployed workers in March 2001. In addition, the median duration of unemployment in July 2007 was 8.9 weeks; in other words, half of all the unemployed were in a jobless spell that has already lasted 8.9 weeks or longer. This compares with a median duration of unemployment of 6.6 weeks in March 2001. Finally, the long-term unemployed represented 11.1 percent of all unemployed workers in March 2001, but accounted for 18.4 percent of the unemployed in July 2007.

^a In its January 2007 economic forecast, CBO projects an unemployment rate of 4.7 percent for calendar year 2007 and 4.9 percent for 2008.

² Advisory Council on Unemployment Compensation, *Report and Recommendations*, February 1994; *Unemployment in the States: Benefits, Financing, Coverage*, February 1995; and *Defining Federal and State Roles in Unemployment Insurance*, January 1996.

the unemployed receiving UI benefits remains lower today than it was before the early 1980s (see Figure 1). Had the panel's recommendations been implemented, the UI system would be far less outmoded today, and the proportion of unemployed workers who receive benefits would be higher.

In recent months, there have been signs of interest in Congress in UI reforms that reflect the spirit of the ACUC recommendations. This spring, Rep. Jim McDermott, chair of the House subcommittee with jurisdiction over the UI system (the Income Security and Family Support Subcommittee of the House Ways and Means Committee), introduced legislation in the House to provide financial incentives to states to institute several UI reforms, including some of the key recommendations of the ACUC. Senator Edward M. Kennedy, Chairman of the Health, Education, Labor, and Pensions (HELP) Committee, subsequently introduced an expanded version of the McDermott bill in the Senate. (These bills are discussed later in this report.)

The emerging debate over UI reform and the reform proposals now under discussion tend to focus on three principal types of coverage gaps that weaken the UI system.

- **The base period for earnings.** To be eligible to receive UI benefits, a claimant must have a record of recent earnings and have at least a specified amount of earnings in a “base period.” (The minimum earnings requirement is set by each state.) The “base period” has traditionally been defined as the *first four* of the most recently completed *five* calendar quarters. Thus, if a worker were laid off in mid-June, earnings over the 12-month period ending *the previous December* would be counted to see if the worker met the minimum earnings threshold. All amounts earned from January through June of the current year would be ignored.

The exclusion of the most recent quarter reflects the fact that when most states designed their UI rules years ago, before recent advances in computerized data records, state UI systems generally lacked access to data on earnings in the most recent completed calendar quarter. That is no longer true today. And the exclusion of earnings in the most recent completed calendar quarter makes it considerably harder for low-wage workers with recent work history to qualify for UI benefits.

For these reasons, the ACUC recommended that a “moveable base period” be used, meaning that earnings from the most recent completed calendar quarter would be counted (and the four quarters used in the computation would represent a more current time period) if doing so would make an applicant eligible.³ A number of states have reformed their base period requirements since the ACUC issued this recommendation over a decade ago, but a majority of states have not yet acted.

- **Non-monetary eligibility criteria.** In addition to meeting a minimum earnings requirement, workers who apply for UI benefits also must satisfy a number of *non-monetary* eligibility criteria. In many states, these criteria include a requirement that an applicant must be looking for *full-time* work, even if the applicant has young children, was working part-time before being laid off, is now looking for comparable work, and fully meets the minimum earnings requirement.

³ ACUC (1995), p. 17.

Proposals to modernize the non-monetary criteria include reforms that would allow people who previously worked part time and meet all other eligibility requirements to receive UI benefits if they are looking for part-time work. Other reform proposals seek to address current eligibility disqualifications in many states that deny benefits to people who have compelling family reasons for having left their previous job — such as domestic violence, a family member’s illness or disability, or the need to move to accompany a spouse whose job location has changed (such as military spouses) — and are again seeking work. Modernizing the non-monetary criteria would be a long overdue recognition of the steep rise in women’s labor force participation in the decades since the unemployment insurance program was created and of the increased importance of part-time work and certain types of family obligations as a consequence of the increased numbers of single working parents and two-earner couples.

- **Extended benefits.** As noted above, the ongoing federal-state extended benefits program (as distinguished from the *temporary* extended benefits programs enacted during recent recessions) functions poorly. The goal of the extended benefits program is to provide additional weeks of benefits to unemployed workers during periods when a state’s job market is weak and employment takes longer to find. Yet because the federal criteria that a state must meet to pay extended benefits are overly restrictive, most states fail to meet the criteria even during recessions.

In addition, in states that do qualify to provide extended benefits, federal restrictions also can unduly limit the number of weeks for which workers are eligible to receive those benefits. Typically, the number of weeks of extended benefits for which an unemployed worker can qualify is a fixed proportion — such as half — of the number of weeks of *regular* UI benefits for which the worker qualifies. This is significant because, although states can pay 26 weeks of regular unemployment benefits to jobless workers, many states place a shorter limit on the duration of the benefits that many workers can receive, depending on an individual’s particular work history; this causes substantial numbers of jobless workers to qualify for fewer than 26 weeks of regular benefits, regardless of how long it takes them to find a job. As a consequence, two workers who have *identical* work histories but live in *different* states may receive extended benefits for a different number of weeks. A worker in one state who qualified for 20 weeks of regular benefits would receive up to 10 weeks of extended benefits after the worker’s regular benefits expired, while a worker with the same earnings history who lived in a different state — and received 26 weeks of regular benefits — could receive the maximum of 13 weeks of extended benefits.

There is a lively debate about how best to address issues related to extended benefits and long-term unemployment.⁴ There is wide agreement, however, that the existing system for meeting the needs of long-term unemployed workers is seriously flawed.

⁴ Some analysts believe that UI should be supplemented with a “wage insurance” program that provides permanently dislocated workers with temporary compensation for taking a job with lower pay. Opponents of wage insurance believe there are too many unanswered questions about the effects of wage insurance and that pursuing it would divert resources from needed reforms to the existing UI program. See, for example, “Meeting the Challenge of Income Instability,” Hearing before the Joint Economic Committee, U.S. Congress, February 28, 2007, <http://www.jec.senate.gov/hearings.htm>. See in particular the testimony of Dr. Lael Brainard, <http://www.jec.senate.gov/Documents/Hearings/02.28.07%20Income%20Instability/Testimony%20-%20Brainard.pdf>, and Maurice Emsellem,

The Congressional Bills

The bill introduced by Rep. McDermott (H.R. 2233) would provide incentives for states to institute certain reforms, particularly reforms that deal with the earnings base period and the non-monetary eligibility criteria. The bill does *not* address problems with the extended benefits program, except to the extent that it would allow states to receive funds to pay extended benefits to workers who are enrolled in a meaningful job-training program. The bill introduced by Senator Kennedy (S.1871) includes the measures that are in the McDermott bill, but goes further. It expands the range of UI reforms for which states would receive federal fiscal incentives and makes those incentives stronger.

The two bills, which both go by the name “The Unemployment Insurance Modernization Act,” extend the Federal Unemployment Tax Act surcharge slated to expire this year, which the President also has proposed extending. (The surcharge has been extended five times since it went into effect in 1977.) The bills would use up to \$7 billion, most of the projected revenues from a five-year FUTA surtax extension, to provide funds that could be transferred to the *state* unemployment insurance trust funds of states that adopt various UI reforms. Under both bills:

- Each state’s potential share of the \$7 billion would be computed in accordance with a formula prescribed under the federal unemployment insurance laws.⁵ (In addition, under the Senate proposal, any carryover funding that remained at the end of the five-year period, because some states had not qualified for their full incentive grants, would be distributed to states that did qualify.)
- One third of a state’s potential share of the \$7 billion would be transferred to the state *if* the state allowed the most recently completed calendar quarter to be used in the base period for determining eligibility for unemployment insurance.
- The remaining two-thirds of a state’s potential allocation would be made available to a state if, in addition to meeting the base-period criterion, the state instituted at least *two* of the following reforms (the last two options are included only in the Senate bill):
 1. An unemployed individual who has been predominantly a part-time worker is not denied benefits just because the worker is now seeking comparable part-time work.
 2. A worker is not denied benefits on the basis of separation from work for compelling family reasons, which include domestic violence, illness or disability of a member of the individual’s immediate family, or the need to accompany a spouse whose job location has changed, making it impractical for the worker to commute (which is particularly important for spouses of members of the military).

<http://www.jec.senate.gov/Documents/Hearings/02.28.07%20Income%20Instability/Testimony%20-%20Emsellem.pdf>

⁵ The formula used under a law known as the Reed Act to allocate money from the federal unemployment insurance trust fund to state unemployment trust funds would be used here as well.

3. Workers in approved job training programs who have exhausted their regular and (if applicable) extended benefits are eligible for at least 26 weeks of additional unemployment benefits while they participate in the training program.
 4. Workers with dependents receive a weekly dependent allowance of at least \$15 per dependent (only in S. 1871). This is designed to better enable unemployed workers with children to receive adequate benefits to meet their families' basic needs.
 5. All workers are entitled to a uniform maximum of 26 weeks of regular unemployment insurance benefits (only in S. 1871). This would enable workers who experience protracted spells of unemployment and qualify for extended benefits during a recession to receive the maximum number of weeks of extended benefits if they are unable to find employment.
- An additional \$500 million in federal funds would be available for transfer to all states for administrative expenses, with the amount provided to each state being proportional to the amount that employers in that state pay in federal UI taxes. These funds could be used to help defray states' costs in implementing the reforms specified in the bill and also would help ameliorate the strains that have been imposed on state UI systems in recent years as a result of cuts since 2001 in federal funding for state UI administrative expenses. (The Senate bill would provide a further distribution of funds for administrative expenses from any carryover funding that was available at the end of the initial five-year period.)

By providing incentives to states to adopt the “moveable base period,” this legislation would address what is widely regarded as one of the most serious gaps in UI coverage that affects low-wage workers. The National Employment Law Project (NELP) estimates that nearly 300,000 additional workers per year would qualify for unemployment benefits under that reform. Based on experience in states that have already adopted such a reform, most of these individuals would be low- and moderate-income workers.⁶ NELP also estimates that overall, the provisions in the House and Senate bills would allow an additional half million workers — 7 to 8 percent of the unemployed — to qualify for UI benefits, with the provisions being well-targeted on low-wage and women workers.⁷

Conclusion

More than 70 years after its inception, the unemployment insurance system continues to provide a valuable cushion against income losses from temporary unemployment, as well as to serve as an especially effective automatic stabilizer for the overall economy by shoring up workers' purchasing power during economic downturns. For nearly two decades, however, major gaps in UI coverage have been evident. Those gaps have especially affected low-income workers, women, and workers who have suffered permanent job losses.

⁶ Maurice Emsellem, Andrew Stettner, and Omar Semidey, “The New Congress Proposes \$7 Billion in Incentive Payments for States to Modernize the Unemployment Insurance Program,” National Employment Law Project, July 25, 2007.

⁷ *Ibid.*

Congress now has an opportunity to use funds that will be made available through renewal of the FUTA surcharge to provide states with financial incentives to make long-overdue UI reforms, including reforms called for more than a decade ago by the bipartisan Advisory Council on Unemployment Compensation. The Unemployment Insurance Modernization Act (especially the Senate version) would address some of the most important reforms that have been recommended, such as the need to narrow gaps in coverage caused by reliance on an outdated base period and by eligibility criteria that fail to recognize some of the modern realities of work and family. Steps also are needed to reform the extended UI benefits program and to find a good way to address job losses that are permanent rather than temporary in nature.