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HOUSE REPUBLICAN PROPOSAL WOULD UNDERMINE FOUNDATION OF UNEMPLOYMENT INSURANCE SYSTEM

By Hannah Shaw and Chad Stone

A provision that some policymakers may seek to include in legislation to extend the payroll tax cut through the end of 2012 would authorize the Secretary of Labor to let up to ten states per year use unemployment insurance (UI) funds for purposes other than paying benefits. The provision, part of the full-year payroll-tax bill that the House passed in December, would undermine UI's fundamental purpose since its creation in the 1930s.

As the bipartisan, blue-ribbon "Norwood Commission" (the Advisory Council on Unemployment Compensation, appointed by the President and congressional leaders) observed more than a decade ago, "The most important objective of the U.S. system of Unemployment Insurance is the provision of temporary, partial wage replacement as a matter of right to involuntarily unemployed individuals who have demonstrated a prior attachment to the labor force."¹

Workers eligible for unemployment benefits have effectively paid taxes into the UI system, often for many years or decades. Technically, employers pay the UI tax, but economists agree that *employees* largely bear the burden of the tax in the form of lower wages than they otherwise would receive, much as employees effectively bear the burden of the employer share of Social Security and Medicare payroll taxes. Yet, under the House provision, states could obtain waivers to change their UI programs in ways that deny benefits to people who have been working (and effectively paying UI taxes) for years and then lose their jobs through no fault of their own.

Moreover, the House proposal could enable states to *replace* state or local funds now used for job training or other such purposes with diverted UI funds and then to *shift* the withdrawn funds to other uses, including tax cuts. The net result could be a reduction in unemployment benefits with little or no offsetting increase in employment services.

States Already Have Substantial Flexibility Over Their UI Systems

The UI system already features extensive state flexibility. As Franklin D. Roosevelt's Committee on Economic Security, which provided the basic blueprint for what would become the Social

¹ Advisory Council on Unemployment Compensation, "Unemployment Insurance in the United States: Benefits, Financing and Coverage," Report to the President and Congress, February 1995, pg. 8.

Security Act, stated, “The States shall have broad freedom to set up the type of unemployment compensation they wish.”²

Federal requirements for state UI systems are minimal and are designed to insure both that UI provides a basic level of protection for eligible workers and that the program serves as a macroeconomic stabilizer in times of economic weakness. Federal law defines unemployment compensation as “cash benefits payable to individuals with respect to their unemployment”³ and lays out a few basic requirements, principally the following two:

- “all money withdrawn from the unemployment fund of the State shall be used solely in the payment of unemployment compensation”;⁴ and
- states cannot impose excessively burdensome “methods of administration” that block access for otherwise eligible individuals.⁵

These requirements ensure that states maintain programs that offer a basic level of protection to workers with a sufficient employment record who lose their jobs through no fault of their own. Within these basic protections, states are free to choose and adjust employer tax rates, benefit levels and duration, and eligibility criteria, such as the extent and duration of prior employment necessary to qualify for benefits.⁶

House Proposal Goes Well Beyond Added Flexibility

The House proposal goes well beyond giving states “flexibility” — it alters the fundamental nature and purposes of the UI program itself. Under the House provision, states could receive waivers that exempt them from the two key federal provisions listed above, allowing them to use UI funds for purposes other than providing benefits and to remove basic protections that insure adequate access to benefits. States also could receive waivers that allow them to condition receipt of benefits on factors unrelated to workers’ having amassed a sufficient work record, having become unemployed due to no fault of their own, and looking for a new job.

Permitting the use of funds for purposes other than providing UI benefits would start the UI system down a slippery slope that would alter its fundamental nature. That is true even if the purposes to which states diverted UI funds would seem to benefit some unemployed workers, such as providing additional job training.

² Frances Perkins, “Report to the President of the Committee on Economic Security,” Committee on Economic Security, 1935, <http://www.ssa.gov/history/reports/ces.html>.

³ Section 3306(h) of the Federal Unemployment Tax Act.

⁴ Section 3304(a)(4) of the Federal Unemployment Tax Act.

⁵ Section 303(a)(1) of the Social Security Act.

⁶ For example: the minimum weekly benefit amount ranges from \$5 in Hawaii to \$135 in Washington state; maximum UI tax rates are below 6 percent in several states, but over 10 percent in others; six states offer fewer than 26 weeks of regular benefits, while two states offer more than 26 weeks; the taxable wage base in Arizona and a number of other states is \$7,000 (the federal minimum) but exceeds \$30,000 in five states.

Moreover, as noted, the House proposal could enable states to *replace* state or local funds now used for job training or other such purposes with diverted UI funds and then to *shift* the withdrawn funds to other uses, including tax cuts. The net result could be a reduction in unemployment benefits with little or no offsetting increase in employment services.

Removing the federal protection against excessively burdensome administrative barriers also is problematic. UI is not available to people who quit their job voluntarily or who have been fired for cause; applicants must also have a substantial recent work history and meet other requirements to qualify. The protection against excessively burdensome administrative barriers does *not* prevent states from placing further restrictions on UI eligibility; states can and do place such restrictions. That is why *fewer than 40 percent* of the unemployed receive UI benefits in a normal labor market.

Going well beyond this, however, and waiving the prohibition against excessively burdensome administrative obstacles would open the door for policies aimed at reducing UI receipt among individuals who meet the program's eligibility requirements. Such policies could help satisfy the desire of powerful employers and other interests in some states to reduce UI benefit costs and tax rates, but in a manner that is less overt than cutting weekly UI benefit levels or shrinking the number of available weeks of regular state UI benefits.

Finally, the House provision would also allow states to use waivers to override the provision of law which requires that unemployment compensation be paid to laid-off workers "with respect to their unemployment," a provision that the Labor Department has long interpreted to mean that workers' eligibility "must be determined solely on the fact or case of their unemployment." In other words, states may not deny initial UI eligibility to someone who meets all state requirements regarding prior employment, the reason for the worker's loss of employment, and the worker's current status as unemployed, and states must maintain eligibility for workers who comply with state requirements to search for and accept new employment. States may *not* impose other, extraneous eligibility requirements and restrictions, such as requiring UI recipients to have a high school diploma or GED; but they could do so through federal waivers under the House provision.

Job Training and Other Services Should Complement, Not Replace, UI Benefits

Helping unemployed workers find new jobs is important, and job training, adult education and other such services should complement the UI system. Such services are not, however, a substitute for basic unemployment compensation. As the Norwood Commission stated, the primary goal of unemployment insurance is to "help to meet the necessary expenses of these workers as they search for employment." The Commission also observed that, "Their search for productive reemployment should be facilitated by close cooperation among the Unemployment Insurance system and employment, training, and education services."⁷

One way to enable more unemployed workers to participate in job training and adult education, which are heavily oversubscribed in many areas and often have waiting lists, is to invest in these programs to ensure they are effective and are more widely available. Unfortunately, state and federal policymakers have cut funding for such programs significantly at a time when the need for them has increased.

⁷ *Ibid.*