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Lessons from the American Federal-State unemployment insurance system for a European unemployment benefits system

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ABSTRACT

The federal-state system of unemployment insurance (UI) in the United States was established by the Social Security Act of 1935 during the Great Depression. Under the program, states provide temporary partial wage replacement to involuntarily unemployed workers with significant labor force attachment. The federal government induced states to establish UI programs through two means: 1) a uniform federal tax imposed on employer payrolls, with a 90 percent reduction granted in states operating approved UI programs, and 2) grants to states to administer their programs. The system has evolved into a collection of separate state programs adapted to different regional, economic, and cultural contexts that all meet the same standards. This paper reviews state practices concerning applicant eligibility, benefit generosity, and benefit financing, with the aim of revealing lessons for a possible European unemployment benefit system (EUBS). We examine areas of federal leadership, explicit federal-state cooperation, and state innovation. While the U.S. system offers some good ideas for setting up an EUBS, there are also lessons in some shortcomings of the U.S. experience. We identify areas of risk for individual and institutional moral hazard in a multi-tiered UI system, and give examples of monitoring methods and incentives to ameliorate such risks. We suggest approaches for gradual system development, encouraging lower-tier behavior, benefit financing, and responses to regional and system-wide crises.

JEL Classification Codes: J65, H81, H87

Key Words: unemployment insurance, European unemployment benefit system, multi-tiered system, moral hazard, incentives, public finance

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BACKGROUND ON THE AMERICAN SYSTEM

The federal-state unemployment insurance (UI) program was established by the Social Security Act of 1935 to provide temporary partial wage replacement to involuntarily unemployed persons actively seeking new jobs. While a few states had nascent programs or draft legislation before 1935, most states and localities were reluctant to independently establish UI programs for fear of competitively disadvantaging resident industries with added costs.[1]

A federal incentive to create state UI programs was provided by the innovation of a tax incentive. A federal unemployment tax was imposed on wages paid by UI-covered employers with a 90 percent reduction in the federal tax granted to employers in states establishing UI systems in conformity with federal guidelines.[2] The tax revenue accruing from the 10 percent retained by the federal government is used for grants to states for program administration, partially supporting federal UI administrative expenses, funding public employment services (ES), paying the federal share of benefits under the permanent extended benefits program, providing support for federal expenses incurred in operating the UI and employment service functions, and making loans to pay regular benefits when state reserves are inadequate. Federal law provides states with the latitude to establish practices that adapt to the economic and cultural conditions in that state. The interplay of federal and state partners has resulted in a system that varies greatly at the state level but maintains important federal standards nationwide.

[1]In 1932, Wisconsin enacted the first state UI law, and Massachusetts and Ohio both had draft legislation before 1935 (West and Hildebrand 1997).

[2]Title III of the Social Security Act established federal grants to the states to perform administrative functions for UI, and Title IX established the federal unemployment tax and related provisions (Blaustein 1993, pp. 151–153). The federal tax rebate incentive for states to establish UI programs was found to be constitutional by the Supreme Court in 1937 (Blaustein 1993, pp. 157–158).

There are five main goals for the federal-state UI system: 1) to provide temporary partial wage replacement during involuntary unemployment, 2) to prevent dispersal of employers' workforces during temporary layoffs, 3) to promote rapid return to work, 4) to limit business downturns by maintaining aggregate purchasing power, and 5) to encourage stabilization of employment in enterprises through experience rating (O'Leary and Straits 2004). The experience rating feature of UI tax contribution rates means that tax rates are higher for employers with more benefit charges, and vice versa. Experience rating is a financing feature of UI that is unique to the United States. In addition to acting as an incentive to stabilize employment, it is intended to reduce moral hazard for layoffs by increasing employer involvement in monitoring UI eligibility, as well as by making employers aware that layoffs have consequences for their tax rate.[3] Over the 80-year history of the program, the main objectives were largely met during the first 40 years, but many program elements have eroded since the 1980s.

The original benefit provisions in most state UI laws were modest, whereas financing features tended to be aggressive. In 1936, the federal taxable wage base of $3,000 was high enough to mean that 95 percent of all wages paid in the country were subject to the 3 percent federal tax rate. The combination led to the accumulation of reserves in the states. Ten years after program establishment, system reserves were over 10 percent of total wages in UI-covered employment (USDOL 2015). The accumulated reserves led to improved benefit levels and longer potential durations. By the 1970s, benefits typically replaced 50 percent of lost wages up to the state maximum weekly benefit amount for up to 26 weeks of involuntary unemployment.[4]

[3]Fath and Fuest (2005) summarize research evidence that experience rating stabilizes employment when it is effective in the United States. However, state taxable wage base limits, tax rate maximums, and solvency taxes limit the range of experience rating and the effectiveness of employment stabilization.

[4]A similar pattern of modest beginnings with improved financing and benefit adequacy over time can be observed in newer UI programs among many countries in Latin America (Summit of the Americas Center 2003).

Today, the financial foundation for UI is weaker, and benefit provisions have been reduced in many states. In fact, since 2010, eight states have cut potential UI duration to less than 26 weeks.[5]

EVOLUTION OF FEDERAL RULES FOR STATE UI CONFORMITY[6]

The existing federal-state UI system is a delicate balance of power that was designed to be self-regulating by a built-in incentive structure. The federal partnership comprises the U.S. Congress and the federal executive branch, which includes the U.S. Department of Labor (both its national and its regional offices), the Office of Management and Budget, and the federal courts. The state partners include the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Within each state and territory, the system includes the state governors and legislatures, state courts, and state UI agencies.

As during the early years of the system, the federal partners continue to hold the upper hand in the relationship. That's because federal requirements for conformity and compliance are central to regulating the system (Table 1). In other words, state UI laws must conform to federal law, and actual state practice must comply with federal regulations.[7] The Social Security Act of 1935 provided 12 minimal requirements. Two requirements were added about the use of UI-granted funds during the early 1940s. New federal laws in the 1950s required coverage to be broadened, resulting in additional requirements, and more new requirements were added in 1970 and 1976. In recent years, an overriding federal concern has been controlling federal spending;

[5]The eight states with UI (potential duration) of less than 26 weeks are Arkansas (20), Florida (12–23), Georgia (14–20), Kansas (16–6), Michigan (20), Missouri (13–20), North Carolina (12–20), and South Carolina (20).

[6]This description was extracted and updated from O'Leary and Straits (2004).

[7]As listed in *Code of Federal Regulations*, Title 20, Chapter 5, Parts 601–625. www.gpo.gov/fdsys/.

consequently, changes to the UI system have often been done as part of the budget reconciliation process, because the federal Unemployment Trust Fund (UTF) is treated as part of the unified federal budget, even though the states raise all the money for supporting their own state UI systems. Accumulated UTF reserves reduce the reported annual federal deficit in any budget year, even though they belong to the states and can only be used to pay a state's UI claims.

A chronology of conformity requirements is given in Table 1. The original requirements covered prompt payment of benefits, location of payments, appeals procedures, management of funds, reporting to the U.S. Department of Labor, and the requirement of experience rating as the basis for receiving the 90 percent reduction in FUTA tax rates. Requirements added in the 1940s and 1950s were included mainly to simplify procedures when interstate claims were involved. In more recent years, states have complained that federal conformity requirements have become more specific and their value more questionable. These requirements govern things like the earnings amount or duration of reemployment required to qualify after a benefit denial, the nonpayment of benefits to professional athletes in the off-season, and rules for reducing benefits based on pension income.

After 1969, when the UI trust fund was first included in the federal unified budget, some new program features were added with the aim of conserving UI funds and improving the overall budget picture. One of these was the 1993 law that established the Worker Profiling and Reemployment Services (WPRS) system to provide early reemployment services targeted to UI beneficiaries at highest risk of long-duration UI benefit receipt.

Table 1 A Chronology of Increasing Federal Conformity Requirements for State Unemployment Insurance Systems in the United States

Original conformity requirements set in 1935 were minimal. They said states must:

- Make full payment of benefits when due
- Make benefit payments through public employment offices
- Have a fair appeals hearing process
- Transfer tax receipts immediately to the Unemployment Trust Fund (UTF)
- Use withdrawals from the state account in the UTF only to pay UI benefits
- Make required reports to the U.S. Secretary of Labor
- Provide information to any federal agency running public works or assistance
- Not deny benefits to eligible individuals
- Not pay benefits until two years after contributions start
- Not deny benefits for refusal to fill a vacancy resulting from a labor strike
- States may repeal their UI laws at their own discretion
- Additional employer rate reductions must be based on experience rating

Additional federal requirements were added in the following years regarding:

- Interstate claims rights
- Rules for combining earnings from multiple employers to gain entitlement
- Broadened coverage of employers
- Allowing claimants receiving approved training to be eligible for UI
- Requirement that states must participate in the Extended Benefits (EB) program
- Denial of benefits to workers who are not legal residents with employment privileges

More federal requirements in later years regard:

- Intervening work required for requalification
- Denial to professional athletes during the off-season
- Benefit reduction for public pension income

Restrictions motivated by the desire to conserve funds in the federal budget:

- The Unified Budget Act of 1969 added the Unemployment Trust Fund to the annual federal budget.
- Federal eligibility requirements for extended benefits were adopted.
- The Balanced Budget and Emergency Deficit Control Act of 1985 was passed.
- New claimants were profiled to identify those most likely to exhaust benefits, and they were required to participate in ES.
- States were required to make withholding of federal income tax possible for beneficiaries.

Federal rules have become increasingly specific. For example, new federal laws in the 1980s and 1990s allowed the use of UI trust-fund money to promote self-employment and short-time compensation.[8] Recent years have seen increased monitoring of compliance with federal guidelines for accuracy and timeliness of benefit payments, appeals, and tax contributions. While

[8]States can use their UI programs to encourage self-employment by providing work-search waivers and continued weekly benefit payments for some beneficiaries at risk of long-duration UI receipt. The UI system is also available to support employer short-time or work-sharing plans, whereby instead of a proportion of workers being laid off, there is a proportionate reduction in hours for all employees in the affected work unit. The employees with reduced hours then receive a share of their full UI weekly benefit amount equal to the proportionate reduction in hours.

both Presidents Truman and Eisenhower proposed standards for state benefits, there have never been conformity requirements on basic matters like the level of the weekly benefit amount and the duration of benefits (Becker 1961). However, the U.S. Department of Labor and federal advisory commissions have offered guidelines to states on these matters.[9] Since the original Supreme Court ruling on the constitutionality of the federal unemployment tax scheme in 1937, judicial involvement in the system has been minimal. Two important cases bear mention. In the case of *California Department of Human Resources Development v. Java*, the U.S. Supreme Court in 1970 ruled that a state may not suspend UI benefit payments during the process of an appeal of a benefit eligibility denial. This required nearly all states to change laws or administration to achieve conformity. In 1994, the U.S. Court of Appeals for the Seventh Circuit, in *Pennington v. Didrickson*, found for Pennington, who had argued that benefit eligibility should be strictly based on demonstrated attachment to the labor force and not necessarily on rules that are administratively simple to apply. Pennington would have been eligible for benefits were the most recent work quarters considered rather than the statutory "first four of the past five quarters." The *Pennington v. Didrickson* ruling permits states to consider an alternate, more recent, base year if the usual base year does not result in eligibility.

STANDARDS FOR PROGRAM FEATURES

Conformity standards govern many aspects of state program design, but other elements are left to state choice. Since the Report of the Committee on Economic Security (January 1935) that recommended a federal-state UI program to the president, there have been two federal

[9]The 1980 National Commission on Unemployment Compensation and the 1996 Advisory Council on Unemployment Compensation both recommended 50 percent wage replacement for up to 26 weeks and a maximum weekly benefit amount set at two-thirds the average weekly wage in UI-covered employment.

advisory commissions on UI: The National Commission on Unemployment Compensation (1980) and the Advisory Council on Unemployment Compensation (ACUC 1996). The Social Security Act (Sec. 908. [42 U.S.C. 1108]) requires that an ACUC-type commission be established by the Secretary of Labor every four years to assess and review the UI program. However, no commissions have been established since the final summary report of the first ACUC. Both commissions sponsored research on all aspects of the program and offered guidance to states on discretionary aspects of program design. The following summary relies on those recommendations.

Eligibility

Unemployment insurance in the United States is regarded as social insurance, having elements of both private insurance and social welfare. Eligibility rules are set to reduce individual moral hazard by requiring three things: 1) that applicants be involuntarily jobless because of an unavoidable job separation; 2) have sufficiently strong recent attachment to the labor force; and 3) be able, available, and actively seeking work. The greatest variation among states is the difference in the level of recent income required to qualify for UI benefit eligibility. Some states require as little as $1,000 over the prior base year, while others require as much as $5,000. To accommodate administrative systems, the base year is normally defined as the first four of the past five completed calendar quarters. The *Pennington* decision and federal encouragement has induced states to consider earnings over the most recent four quarters when income was not sufficient over the standard period.

States maintain records of all wages paid by UI-covered employers. These wage data can be readily accessed to assess eligibility and entitlements for UI applicants. The majority of state rules for benefit eligibility, levels, and durations are computed on base-period earnings drawn from wage records. Naturally, UI applicants can add wages based on documentation if administrative wage records are incomplete. Wage records are also used by states to set program parameters, including the maximum weekly benefit amount.

Generosity

The standard of benefit adequacy accepted in the research literature is 50 percent wage replacement for up to six months, with a maximum benefit amount equal to two-thirds the average wage in covered employment (ACUC 1996). These levels were common among states by the 1960s and for more than 50 years thereafter, but in response to the UI debt accumulated by states during the Great Recession, eight states have retreated from these common levels of benefit adequacy (O'Leary and Kline 2016).[10] In the United States, there are no fixed federal requirements for duration or periodic amounts.

Financing: FUTA and SUTA

Financing provisions in the Social Security Act of 1935 applied a 3 percent tax rate paid by employers on all wages except those in Michigan and New York, where the taxable wage base was set at $3,000 (Blaustein 1993, p. 161).[11] The Federal Unemployment Tax Act (FUTA) of 1939 set the federal taxable wage base at $3,000. That level equaled the Social Security taxable wage base at the time. Since 1951, the Social Security taxable wage base has risen dramatically, while the UI taxable wage base has stagnated (Figure 1). The FUTA taxable wage base also sets the minimum taxable wage standard for states. The FUTA tax rate is reduced by 90

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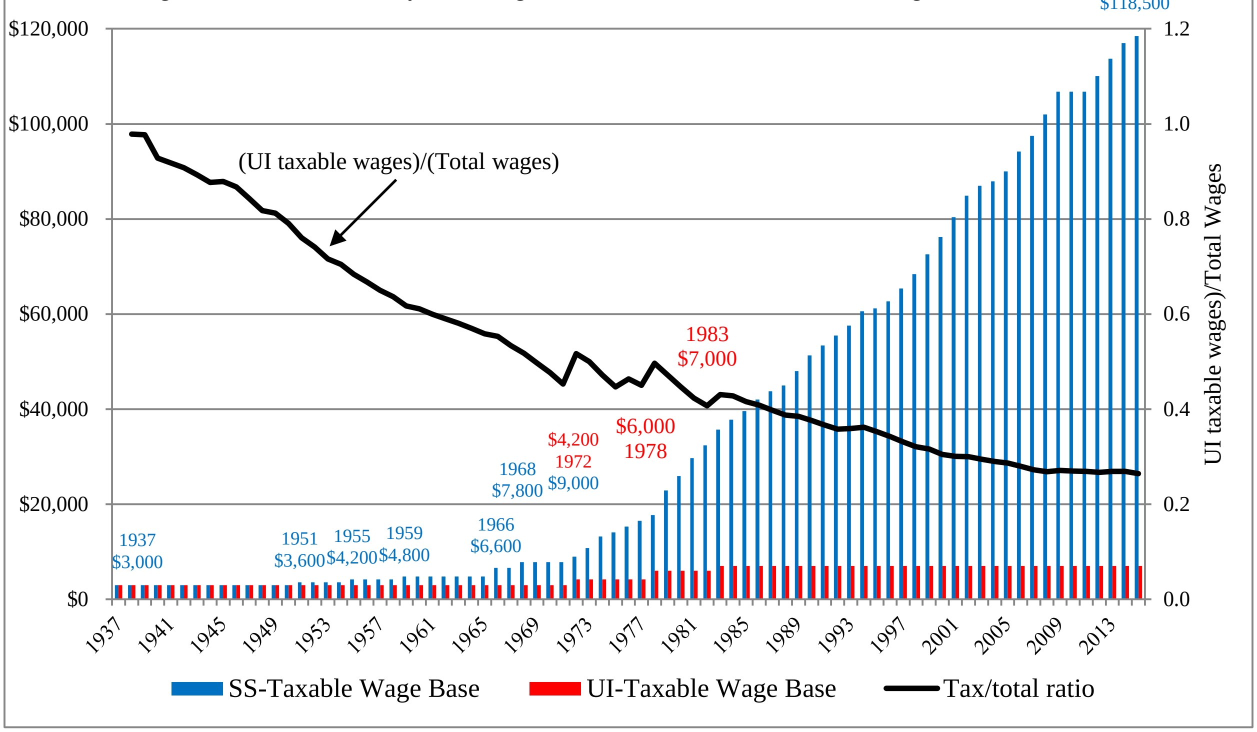
[10] The National Bureau of Economic Research business-cycle dating committee set the official length of the contraction starting in December 2007 at 18 months. It was the longest U.S. contraction since the Great Depression, which started in August 1929. The Great Recession earned its name not only from its length but from the speed of decline following the evaporation of credit, the permanence of high-wage job loss, and the international ripples it caused, which are still being felt (Grusky, Western, and Wimer 2011).

[11] Originally, a handful of state unemployment tax laws also required employee contributions. Today, only Alaska and New Jersey have employee contributions, with a Pennsylvania employee tax triggering in crisis periods. It should be noted that employee taxes probably increase UI take-up among eligible unemployed, thereby resulting in higher system costs for a given level of unemployment. There is research evidence that even in the current situation, where employers directly pay the tax, employees indirectly share in the cost of financing UI benefits by accepting wages that are lower than would prevail in the absence of UI (Anderson and Meyer 2000).

percent to employers in states with conforming UI programs. The federal FUTA revenues are used to pay for state administration of UI programs, a share of federal staff in the Office of Unemployment Insurance, delivery by state staff of public ES, the federal share of extended benefits, and the reserve for loans to states.

Figure 1. UI and Social Security taxable wage bases and the ratio of total to UI taxable wages, 1937-2015



SOURCE: USDOL (2016) and SSA (2016).

Since 1939, the FUTA tax base has been increased only three times; most recently it reached $7,000 in 1983. The FUTA taxable wage base now stands at less than 6 percent of the Social Security taxable wage base. In 1937, more than 95 percent of all wages and salaries in UI-covered employment were subject to the FUTA tax, but by 2015, only about 25 percent were subject to the FUTA tax (O'Leary and Kline 2016). All states must have state tax rates that are at least 90 percent of the FUTA levels before reduction, and they must have taxable wage bases that are at least at the FUTA level. Under the so-called state unemployment tax acts (SUTA), two state taxable wage bases are at the federal minimum of $7,000 and more than half are less than double the FUTA base. The stagnant tax base has contributed to insufficient buildup of reserves to forward-fund benefits, which has resulted in adverse distributional consequences and tax incidence. The insufficient forward-funding may have contributed to eight states reducing potential benefit durations over the past five years (O'Leary 2013). The limited tax base may also dampen hiring of low-wage workers, for whom employers pay a relatively larger share of total annual compensation in UI taxes. Naturally, states could alternatively improve benefit financing by raising tax rates instead of the tax base, but raising tax rates appears to be an even more challenging political maneuver.

The ACUC (1996) recommended incentive approaches for inducing states to forward-fund benefits. For example, one approach would be to adjust interest payments on positive-balance reserves so that they were at a higher rate for balances above an adequate level of reserves and at a lower rate for reserves below that threshold. The average high-cost rate (AHCR) for a state UI system is the average over the past 20 years of the three highest values of the ratio of benefit payments to total taxable payrolls. The U.S. Department of Labor target for forward-funding is that AHCR be at a value of one or higher.[12] The USDOL judgment in setting this target is that one year of average recession-level benefits in reserve, together with regular system revenues, should be sufficient to avoid borrowing in most recessions. Vroman (2016) asserts that UI financing systems operate best when kept in balance with benefit systems. That is, if the maximum benefit amount increases with average wage levels, then the taxable wage base

[12]In 2010, this USDOL rule was put into place as a federal requirement for interest-free short-term Title XII loans. The final regulation on this was published in the *Federal Register* on September 17, 2010, as 20 CFR, Part 606.

should also increase along with average wage levels. If not, over time a structural imbalance will emerge from wage growth in which benefit payments exceed tax revenues.

Reemployment

The UI work test is part of the social insurance aspect of UI to reduce the moral hazard of avoidable joblessness. As noted above, the work test requires beneficiaries to be able, available, and actively seeking work. By statute, the work test is enforced by the state Employment Service, which is almost entirely funded from federal FUTA tax receipts. The 1935 federal statute required state UI claims to be filed in public ES offices. The implicit idea was to link UI benefits to reemployment efforts. Although today UI applications must still be reviewed by ES employees, UI applications now are most commonly done through telephone call centers or on-line through the Internet. The new modes of benefit application have changed the linkages between UI and ES over the years and have also changed the enforcement of UI work search requirements.[13] One effort to at least partly renew the connection was embodied in federal legislation establishing the Worker Profiling and Reemployment Services (WPRS) system in 1993. The WPRS system required states to identify UI beneficiaries most likely to exhaust benefit entitlement. WPRS services are delivered in One-Stop Career Centers (now called American Job Centers) under the Workforce Investment and Opportunity Act of 2014. Another link for UI beneficiaries to reemployment services is permitted by state job-search waivers granted to beneficiaries who are referred to job training programs approved by the state employment commissioner. Work-search exemption is also granted to beneficiaries permitted to

[13]O'Leary (2006) summarizes state UI work-search requirements and research evidence on the effectiveness of reemployment services for UI beneficiaries.

pursue self-employment under UI laws in seven states that were originally authorized by provisions of the North American Free Trade Act (NAFTA) of 1993.

Because the FUTA taxable wage base has remained fixed since 1983, funding for ES programs has stagnated, falling in real terms by far more than half (O'Leary and Eberts 2008). Failure to fully comply with the work test has been identified as one of the main sources of UI payment errors (Burgess and Kingston 1987; Clarkwest et al. 2012). In an effort to restore a reemployment emphasis to UI, the Labor Department funded the Reemployment and Eligibility Assessment (REA) program, in which states participate on a voluntary basis. Some research evidence suggests that shorter UI durations from WPRS result from the unwelcome prospect of having to participate in services rather than the actual content of those services (Black et al. 2003), but a more recent evaluation involving randomized controlled trials suggests a positive value for reemployment services (Michaelides et al. 2012). With ES funding remaining stagnant, USDOL in 2015 made grants to states to use WPRS to target REA in American Job Centers under an expanded program called Reemployment Services and Eligibility Assessments (RESEA), which replaced REA in October 2015.

As states increasingly required UI claims to be filed by telephone or through the Internet, contact between UI applicants and employment services decreased. In 2010, USDOL established a work group composed of leaders at the federal, state, and local levels to develop approaches to better connect UI with other employment and training programs. The work group developed a national vision for better connecting these programs, and three key "transformational elements" were tested on a pilot basis in New York and Mississippi and were subsequently evaluated by Martinson et al. (2015). The three concepts piloted were 1) *integrated workforce registration*, which enabled claimants to simultaneously register for a range of programs, including UI, ES, and WIA; 2) *real-time triage*, which involves continuously making use of accumulated data on claimants to provide claimants with an updated mix of possible services they could access; and 3) *skills transferability*, which includes new ways of matching claimants with new occupations based on the claimants' skills, backgrounds, and interests.

AREAS OF EXPLICIT FEDERAL-STATE COOPERATION

Permanent Federal-State Extended Benefits Program

The Extended Unemployment Compensation Act of 1970 created a permanent program for UI extended benefits (EB) to be paid when the insured unemployment rate (IUR) exceeded set trigger levels.[14] The EB program involves a 50-50 sharing of benefit payment costs between federal and state governments. When triggered, the EB program lengthens potential durations by 50 percent of the entitled duration of regular UI benefits. In most states, that means an additional 13 weeks of benefits after the entitlement to regular UI is exhausted.[15] Benefits under EB are paid at the same weekly rate as regular UI. The EB program paid benefits in recessions in several states during the first 10 years after enactment, but it has rarely been triggered since that time.

Originally, the EB program was a good example of federal-state cooperation. However, in recent years the triggers based on insured unemployment have rarely activated EB when total unemployment rises (Nicholson and Needels 2006). Under the original 1970 law, EB could be activated by a national trigger affecting all states, or a state-level trigger affecting EB only in that

[14]The IUR is the rate of insured unemployed persons in a period as a percentage of the UI-covered employed persons in the period. This ratio depends on the rate of UI application, the rules for benefit eligibility, and the enforcement of eligibility rules.

[15]States can opt to add an additional 25 percent of the regular potential duration to the EB duration.

particular state.[16] In the early 1980s, the national trigger was eliminated and the state trigger threshold was raised from 4.0 to 5.0 percent (Woodbury and Rubin 1997).[17] Additionally, increasing eligibility requirements in some states resulted in low UI recipiency rates and low IUR rates that failed to trigger EB even when the total unemployment rate (TUR) had risen quite high (Blank and Card 1991). In response to the failure of EB to be activated in more than a few states during the early 1990s recession, Congress in July 1992 passed legislation allowing states to adopt an alternative trigger based on the total unemployment rate (TUR) as estimated by the Current Population Survey.[18]

In the 1990s and 2000s, emergency federal UI extensions were structured to be paid before any EB that might be available. Consequently, the EB program has not actively functioned in the past 40 years. The ARRA provided temporary 100 percent federal reimbursement of EB payments for states that adopted alternative EB triggers based on the TUR. The 100 percent payment for EB was continued through midyear 2014 for states with conforming TUR triggers. All states that adopted TUR triggers had EB become effective during the Great Recession, but a survey of states revealed that almost all TUR adopters said they would return to IUR triggers after the 100 percent federal funding ended (Mastri et al. 2016).

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[16]The original triggers set in 1970 were a national trigger of 4.5 percent IUR over 13 weeks that would activate EB for all states, and a state-level trigger of 4.0 percent IUR over 13 weeks that was at least 120 percent of the IUR in the same period one year earlier.

[17]The Ninety-Sixth Congress included the changes in PL 96-364 and PL 96-499 in 1980 and 1981.

[18]The 1992 UI reforms were included in PL 102-182. The threshold for the alternative state EB trigger was a TUR above 6.5 percent over a three-month period and 10 percent above the three-month average TUR in either of the two preceding years.

Data-Sharing for Interstate Claims and Benefit Payments

Payment of UI benefits to job seekers with work experience in other states is accommodated by interstate data sharing through the Wage Record Interchange System.[19] The arrangement accommodates free mobility of job seekers across state borders. Interstate data-sharing agreements that are based on federally supported computer systems permit states where claims are filed to act as agents for other states when the majority of base-period income for the claimant was earned in other states. The agent state determines eligibility, disqualifications, and the amount and duration of benefits based on rules in the state where the majority of base-period wages were earned. The 1970 amendments to the Social Security Act further clarified the way in which earnings from more than one state are combined to determine entitlement and to attribute liability for benefit charges to prior employers. The Interstate Benefits System exists to provide methods of exchanging information among states and Canada to support payment of UI benefits to eligible applicants.

Payment Integrity

Benefits accuracy measurement

The Improper Payments Information Act (IPIA) of 2002 requires executive agencies of the U.S. government to examine the risk of erroneous payments in all programs and activities they administer. The Benefit Accuracy Measurement (BAM) program is designed to determine the accuracy of paid and denied UI claims. In cooperation with the U.S. Department of Labor, state UI programs select weekly random samples of UI payments and denied claims. BAM investigators audit these paid and denied claims to assess their accuracy. The BAM auditors are

[19]Instructions to states for administering interstate benefits and for combining earnings in different states are covered in Employment and Training Administration Handbooks No. 392 and No. 399, respectively.

state employees following USDOL audit procedures. They are paid with money from the UI administrative grant to states, which comes from FUTA revenues in the UTF. Between 8 and 12 cases are selected for audit each week in every state. The results are reported annually to the Office of Management and Budget and published. Over the past 10 years, payment error rates have ranged from 9 to 12 percent, averaging about 10 percent.[20] For 2015, the overpayment rate was 10.3 percent and the underpayment rate 0.4 percent; these include an estimated fraud rate of 2.9 percent and an administrative error rate of 1.6 percent (USDOL 2015). BAM is an essential part of efforts to identify and control UI system costs. Any UI overpayments are subject to recovery by the UI administrative agency, whether detected by BAM or other means. Repayment of prior overpayments is often done through reduction of future UI payments. Overpayments due to fraud can result in a disqualification from UI benefit receipt for a definite period of time, and sometimes legal action to recover funds.

UI performs

The Government Performance Results Act of 1993 requires each executive agency to do four things: 1) establish performance goals for each program activity, 2) express the goals in measurable form, 3) describe the operational process, and 4) establish performance indicators. In addition to cooperating on periodic comparison-group-designed impact evaluations with the USDOL chief evaluation officer, the USDOL's Office of Unemployment Insurance conducts ongoing monitoring of gross outcome measures. The performance measurement system is called UI Performs. It monitors administrative performance measures (using 2015 rates) including: rate of timely payments (83.7 percent), rate of detecting recoverable overpayments (61.2 percent),

[20]A history of UI error rates can be found at https://paymentaccuracy.gov/programs/unemployment-insurance.

and rate of employer tax liability determinations (87.3 percent).[21] UI Performs also tracks one program outcome measure: the reemployment rate for UI claimants (67.7 percent).

The reemployment outcome is a gross measure of program success. It is checked by matching claims with administrative data on the presence of earnings in the calendar quarter after the UI benefit year started. The performance measures for tracking administrative outcomes have various motivations. The maintenance of a timely UI payments system became a policy concern for the USDOL following the 1970 federal court decision in the case of *California Department of Human Resources Development v. Java*. That decision required states to make UI payments "when due"—that is, in a timely fashion relative to the date of application rather than after the end of what could be a protracted eligibility appeals process. "Reviewing the history of the Social Security Act led the court to the conclusion that "when due" was intended to mean at the earliest stage of unemployment that such payments were administratively feasible after giving both the worker and the employer an opportunity to be heard (USDOL 1971). Monitoring recoverable overpayment rates is a way to encourage state accuracy on the benefit payment side, and monitoring the rate of tax determination encourages accuracy on the system revenue side. These four summary performance indicators are representative of a finer set of performance measures based on four quarters of administrative data.[22]

Reed Act Distributions

Originally, employer FUTA tax payments were recorded as general revenues of the U.S. government, and UI administrative expenses were paid for out of general revenues. By the early

[21] A summary of these main UI performance targets and results can be found at http://www.oui.doleta.gov/unemploy/docs/GPRA_Summary_Report.asp.

[22] For example, benefits accuracy is measured by four indicators, program integrity is measured by four indicators, appeals timeliness is measured by three indicators, and there are three tax indicators. Details can be found at http://www.oui.doleta.gov/unemploy/pdf/Core_Measures.pdf.

1950s, it was estimated that FUTA revenues exceeded UI administrative grants to states by between $500 million and $1 billion annually (West and Hildebrand 1997). The Employment Security Administrative Financing Act of 1954 requires that any excess amount of FUTA revenues over UI administrative grants to states be deposited to the UTF in a new account to make loans to states when their reserves were insufficient to pay UI benefits. The financing act, commonly called the Reed Act, set a limit on the level of reserves in the loan account and provided that reserves above that ceiling level be distributed to states for payment of regular benefits, program administration, or delivery of ES.[23] Over time, the Reed Act ceilings became less binding as Congress, motivated by the desire to control annual deficits in the unified federal budget, relaxed the Reed Act ceiling trigger from 0.33 percent of total payrolls in UI covered employment in 1982 to 1.02 percent of covered payrolls today (Vroman 2008). Consequently, the incentive supplied by the Reed Act for Congress to adequately appropriate money from the UTF for UI administration has diminished. Nonetheless, the Reed Act mechanism is an important example of a mechanism for maintaining balance in a decentralized federal-state system.

AREAS OF STATE INNOVATION

Bond Financing of Benefit Payment Debt

An alternative to forward-funding is pay-as-you-go financing of benefits. The fundamental principle of finance is that "money today is worth more than money tomorrow." By keeping employer UI taxes low, states will likely see declining reserve balances when

[23]The 1954 law (P.L. 83-567) became known as the Reed Act after its sponsoring representative, Daniel A. Reed of New York.

unemployment rises, but they keep money in the hands of private-sector businesses, where jobs are created. In today's low-interest-rate environment, UI benefit payment debt can be financed by tax-exempt state revenue bonds at interest rates far below the lending rates available from the federal government. Under Title XII of the Social Security Act, states with insufficient reserves can borrow from the U.S. Treasury. Currently the Title XII lending rate is 2.23 percent, while rates on state revenue bonds are below 0.5 percent.[24] Some states have adopted the pay-as-you-go model, which is a rational cost-saving approach in a low-interest-rate environment. However, this will not always be the case. When rates eventually rise, and the spreads between Title XII loans and tax-exempt state revenue bonds shrink or flip, forward-funding will regain appeal. Unfortunately, switching financing schemes in times of crisis can be very costly to states. Not only is forward-funding a countercyclical stabilizer, it is a less risky policy option for states, since advance building of reserves is less risky than dealing with unexpected debt. Most states that bond-financed debts accumulated during the Great Recession did not raise their tax rates or taxable wage bases, but many bond-financing states shortened potential durations of UI benefits. Furthermore, states that financed benefits by bond sales usually had lower-than-average benefit-wage replacement ratios.

AREAS OF FEDERAL LEADERSHIP

Holding State Reserves for Payment of Benefits

The Social Security Act requires that all employer UI tax payments be deposited into the Unemployment Trust Fund (UTF) at the U.S. Treasury. The FUTA contributions paid on

[24]Current Title XII loan rates can be found at www.treasurydirect.gov/govt/reports/tfmp/tfmp_advactivitiessched.htm.

federally taxable payrolls are deposited into the Employment Security Administrative Account (ESAA) in the UTF. Additionally, states are required to promptly deposit revenues from their state unemployment tax act (SUTA) levies into state accounts in the UTF. The U.S. Treasury pays interest on positive reserve balances in state accounts and charges interest on loans to states from the Treasury, except for short-term cash-flow borrowing in any year that is paid back by September 30 of that year.

Financing State Program Administration

The federal-state relationship has been greatly affected in recent years by the federal budget implications of state actions. Tension has been obvious in recent years over the issue of administrative financing. Federal grants to states for UI administration are determined by a formula based on workload factors such as the number of UI claims, appeals, and covered employers. The formula also depends on the estimated time cost of serving claimants and salaries of state UI staff. The time-cost estimates used are based on studies done in the 1970s, with the latest updates having occurred no more recently than 1984. Since that time, there have been many changes in practices and office technology within the states. The federal-state struggle over administrative funding has been a constant source of tension in recent years. Naturally there are economies of scale in automated administrative systems, but some states have objected to the workload-driven formula because states sometimes contribute more to the ESAA than they receive back in administrative grants. Driven by tight budgets, the federal government has tried to conserve funds, while the states have claimed that federal holdings for administration are state entitlements that should be distributed.

Davidson and Martin (1996) have viewed the UI administrative financing standoff as a classic principal-agent problem. The federal partner is the principal seeking to administer a high-quality UI program through its agents, the state employment security agencies. Davidson and Martin argue that to encourage high-quality service, efficient low-cost administration, and continuous quality improvement, the administrative funding mechanism should fulfill two criteria: 1) it should be based on the quality of service as measured through a simple monitoring system operated by the federal partner to assess state practice, and 2) it should permit states to retain unspent financial grants. Special administrative grants could also be made to states with high unemployment or low population density where administrative costs are higher because of these factors but not because of inefficiency. Such a system would also have the effect of encouraging UI taxpayers to monitor administrative efficiency at the local and state levels, so as to increase the share of administrative grants retained for other uses, including benefit payments.

Incentive for States to Forward-Fund Benefits

For a state UI system to be sustainable in the long run, revenues should match expenditures, on average, over business cycles. The accepted standard for UI benefit financing is based on the principle of forward-funding. Having money in reserves when unemployment increases means states do not have to raise employer UI taxes during recessions. Therefore, forward-funding reduces or eliminates any UI tax increases that could drive the economy into a worse situation when business conditions are weak. Accumulating reserves during economic recoveries puts a slight damper on expansions but helps avoid severe financing crises in the depths of recessions.

To achieve adequate forward-funding, state accounts in the federal Unemployment Trust Fund (UTF) should maintain balances “sufficient to pay at least one year of unemployment insurance benefits at levels comparable to its previous high cost” (ACUC 1996, p. 11). In 2010, this rule was put into place as a federal requirement for interest-free loans. The rule requires states to hold one year of reserves in the UTF equal to the average of the three highest-cost rates experienced in the prior 20 years. This rate is known as the average high-cost rate (AHCR). The rule becomes fully effective in 2019; in 2014, it started to be phased in at a target rate of 50 percent of the AHCR and increases of 10 percentage points each year until it reaches the AHCR in 2019.

Loans to States to Pay Benefits

Most states that exhaust their reserve balance use the normal UI benefit financing procedure for loans available from the U.S. Treasury under Title XII of the Social Security Act. Funds available for loans to states are accumulated from the annual FUTA tax levy that all UI-covered employers pay. As mentioned in the previous subsection, adequate forward-funding means zero-interest short-term loans will be available, but states must pay interest charges on loan balances that remain outstanding after September 30 in any given year. The interest rate moves in tandem with yields paid in the market for U.S. Treasury bonds. For example, rates since 2008 have ranged from 4.94 percent down to 2.23 percent, with the current rate at 2.23 percent.[25]

A total of 36 states borrowed from the U.S. Treasury between 2009 and 2013. "By the end of 2015, 10 states still had outstanding loan or bond debts. Four state UI programs (California, Connecticut, Ohio, and the U.S. Virgin Islands, which is counted as a state) are still paying on loans from the U.S. Treasury, while six other states (Colorado, Illinois, Michigan, Nevada, Pennsylvania, and Texas) are still repaying other loans or bond debts from UI benefit payments" (O'Leary and Kline 2016, p. 1). In terms of systemic risks to the loan fund, Vroman

[25]U.S. Treasury loan rates can be found at https://www.treasurydirect.gov/govt/rates/rates_tfr.htm.

(2012, p. 4) finds that “the largest states seem likely to be among the last to fully repay their UI loans.”

Discretionary Emergency Extensions of Benefits

Since the 1950s, the federal government has provided emergency unemployment compensation (EUC) every time the annual average national unemployment rate has risen above 6 percent. There have been eight EUC-type programs, each enacted at congressional discretion, and all completely or mostly funded by general revenues of the federal government. Starting with President Eisenhower, every U.S. president except Lyndon Johnson signed a bill initiating or extending federal EUC. During the Great Recession, the program EUC08 was first enacted in 2008 and subsequently revised and extended several times; the last updates came as part of the Middle Class Tax Relief Act of 2012. At its peak, the combination of EUC08 and EB provided up to 73 weeks of benefits on top of 26 weeks of regular UI. To be eligible for some funds from EUC08, beneficiaries must have exhausted regular state UI. No EUC08 benefits were paid after January 2, 2013.

Economic theory suggests that longer potential UI durations can induce longer periods of benefit receipt (Decker 1997). Some scholars suggest this happened in the 2008–2012 period, when generous EUC was available with longer durations; however, others find no evidence that EUC affected the rate of leaving insured unemployment (Farber, Rothstein, and Valletta 2015). In addition to partially replacing lost income, UI also aims to help stabilize the macroeconomy and arrest the descent into poverty by the unemployed. Yang, Lasky, and Page (2010) of the Congressional Budget Office (CBO) assessed the timeliness and cost-effectiveness of 11 macroeconomic stimulus measures. They rated EUC the most effective because of a large income multiplier, and because EUC is a one-time expenditure that does not add to the nation’s structural deficit. A related CBO analysis by Acs and Dahl (2010) found that among households in 2009 with at least one member of the household unemployed, those receiving EUC08 had a poverty rate of 19.6 percent, while the poverty rate of those same households would have been 24.3 percent without EUC.[26]

In addition to EUC08 extending UI benefits during the Great Recession, the American Reinvestment and Recovery Act (ARRA) of 2009 provided for Federal Additional Compensation (FAC) to increase all UI weekly benefit amounts by $25 a week through June 30, 2010, at a cost of $9 billion. This FAC was subsequently extended to December 31, 2010. The ARRA also provided 65 percent subsidies for up to 12 months of extended health insurance premiums for UI-eligible persons who had lost their jobs on or after September 1, 2008.

Program Innovations

In recent years, new UI program elements have been added by the federal government as state options. These have been intended to provide flexibility in meeting worker and employer needs. Three features of particular importance involve 1) targeting reemployment services to those most likely to exhaust UI benefits, 2) waiving UI work-search for those starting self-employment, and 3) using short-time compensation (STC or worksharing) arrangements to avoid layoffs.

Concern for helping dislocated workers displaced by industrial restructuring in the 1980s led to a series of field experiments in UI (Wandner 2010). Among these field experiments, the New Jersey reemployment experiment provided evidence that early reemployment services delivered to dislocated workers could shorten their average duration of UI benefit receipt. This

[26]One could note that Acs and Dahl (2010) did not consider behavioral response to longer potential UI durations, but it must be recognized that labor demand was exceptionally weak throughout 2009.

evidence led to the establishment of the Worker Profiling and Reemployment Services (WPRS) system.[27] The WPRS systems were set up in all states to identify UI claimants most likely to exhaust their regular benefits and quickly refer them to employment services for a faster transition to reemployment.[28]

Also in 1993, federal rules permitting states to allow continued weekly UI benefit receipt while pursuing self-employment were adopted as part of the North American Free Trade Agreement (NAFTA). Self-employment initiatives for unemployed persons have been operating in Europe since 1979. Seventeen countries belonging to the Organization for Economic Cooperation and Development (OECD) have self-employment programs. Based on field experiments conducted in the 1980s, self-employment assistance (SEA) became a permanent option for states as part of the 1998 Workforce Investment Act (Benus, Wood, and Johnson 1994). Currently, only seven states have legislation for SEA programs, and the program is only actively used in Delaware, New York, Oregon, and Vermont.

Like self-employment assistance, STC is one of the few public employment policies available to directly address inadequate labor demand. Under STC, work reductions are shared by reducing employees' work hours instead of laying off workers. Unemployment insurance partially replaces lost earnings by paying a percentage of the weekly benefit entitlement equal to the percentage reduction in weekly work hours. Currently, 29 states have STC plans, and in those states STC is used relatively infrequently compared to regular UI. The Middle Class Tax Relief and Job Creation Act of 2012 (PL 112-96, Title III, Subtitle D) includes many features promoting STC in the states. The inducements include temporary reimbursement of STC benefits

[27]President Bill Clinton established the WPRS system in 1993 by signing P.L. 103-152.

[28]Eberts, O'Leary, and Wandner (2002) edited papers providing the background on WPRS and examples of targeting reemployment services in various programs. See titles of the book's various chapters at http://research.upjohn.org/up_press/144/.

to states by the federal government for up to three years. Having STC programs in all states would offer a valuable federal stimulus channel in times of economic crisis.

Mentoring State Program Administrators

The U.S. Department of Labor, together with the National Association of State Workforce Agencies (NASWA), mentors new state UI program administrators and state program management staff. In most cases, the chief state UI administrator is a political appointee who serves for a limited time period. However, the legal responsibilities of the position are real, and the decisions that must be made often carry great weight. In 2015, the U.S. Department of Labor published a manual for state administrators titled "Unemployment Insurance Directors Guide." The manual provides a comprehensive summary of the program and the director's responsibilities. In addition to general annual conferences on workforce development, NASWA hosts annual UI director's conferences. These institutions accelerate the learning process for UI program administrators. Additionally, the U.S. Department of Labor has well-established mechanisms for documenting regulations that are contained in the *Federal Register*, reviewing state proposed legislative changes for federal conformity, and publishing occasional program letters announcing available grants and program changes. Annual events are scheduled for training state staff in areas of program emphasis, including financial forecasting of reserve balances and updating WPRS profiling models. The resources available to state directors and their administrative staffs are well developed and continuously improving.

UI Modernization under ARRA[29]

The American Recovery and Reinvestment Act (ARRA) of 2009 provided financial incentives for expansions of UI eligibility that together were referred to as UI modernization. The incentives were offered to expand aspects of UI eligibility. The financial incentives totaled $7 billion and were allocated to states based on their share of national unemployment. States could receive one-third of their potential incentive payment for having an alternate base period (ABP) available for monetary determination of UI eligibility that includes the most recently completed calendar quarter. States could receive the remaining two-thirds of their allocation for having any two of the following four additional program features: 1) UI eligibility while seeking only part-time work, 2) UI eligibility after job separations due to harassment or compelling family reasons, 3) continuation of UI benefits for at least 26 additional weeks after exhaustion of regular benefits while in approved training, and 4) dependents' allowances of at least $15 per dependent up to $50.

By the conclusion of the program-funding year that ended on June 30, 2011, when the incentive offers expired, 41 states had received modernization payments for having an ABP, and 36 of these states also received the remaining two-thirds of their available funds. The number of states adopting each of the additional features was as follows: 28 extended eligibility to claimants seeking part-time work, 21 allowed eligibility for those who were unemployed for family reasons, 16 provided benefits to exhaustees while in training, and 7 included dependents' allowances. Some states already had some of the incentivized features, but the features added by states tended to be the options that had a lower expected cost. A total of $4.4 billion, or 63 percent, of the potential total amount of the modernization budget was disbursed under the

[29] This section relies on O'Leary (2011).

program, but nearly $2.6 billion went unclaimed by states. The modernization grants offered temporary financial relief to states during the crisis of the Great Recession but also established future liabilities for states that expanded eligibility to qualify for payments. ARRA prohibited UI modernization payments for state law changes that included a sunset provision, but ARRA did not prohibit states from repealing legislation after they qualified for a UI modernization incentive payment. Five states have already repealed some or all of the expansions of UI eligibility adopted to qualify for modernization payments.[30]

Special Unemployment Benefits Programs

The federal government funds and administers four special unemployment benefit programs: 1) Disaster Unemployment Assistance (DUA), 2) Unemployment Compensation for Federal Employees (UCFE), 3) Unemployment Compensation for Ex-Military (UCX) Personnel, and Trade Adjustment Assistance (TAA). Applicants for these must qualify for UI benefits under regular state programs, and benefits are funded by the federal government. There are usually special eligibility rules in disaster situations, and TAA benefits are payable only after regular UI benefits are exhausted.

When a natural disaster happens, many people involuntarily lose their jobs, at least temporarily. Applicants who qualify for regular UI may receive compensation based on earned entitlement and the disaster-caused job loss. However, if the president of the United States declares a disaster area, DUA is available to any unemployed worker or self-employed individual who lived, worked, or was scheduled to work in the disaster area at the time of the disaster, and

[30]For example, in 2013, Tennessee repealed a UI dependents allowance that was included in state legislation signed into law on June 25, 2009. In 2009, the U.S. Department of Labor issued Tennessee a $47.3 million payment for having an alternate base period and $94.5 million for having a dependents allowance and permitting UI eligibility for claimants who customarily held part-time jobs.

who, because of the disaster, is struggling with one of four situations: the person 1) no longer has a job or a place to work, 2) cannot reach the place of work, 3) cannot work because of damage to the place of work, or 4) cannot work because of an injury caused by the disaster.[31] DUA is not available to persons who are otherwise eligible for regular UI benefits, but DUA *is* available to individuals who become heads of households and are seeking work because the former head of household died as a result of the disaster. This is true even if the new head of household has no prior work history. DUA benefits are payable to those individuals whose unemployment continues to be a result of the major disaster, but only for the number of weeks of unemployment that occurred during the Disaster Assistance Period (DAP). The DAP begins with the first weekday following the date the major disaster began and continues for up to 26 weeks after the date on which a disaster was declared by the president. The maximum weekly benefit amount payable is determined under the provisions of the state law for unemployment compensation in the state where the disaster occurred. However, the minimum weekly benefit amount payable is half (50 percent) of the average benefit amount in the state. DUA has been available to persons affected by natural disasters such as hurricanes, tornados, and earthquakes. It was also offered to affected workers in the New York and Washington, D.C., metro areas after the terrorist attacks of 2001.

The Trade Adjustment Assistance (TAA) program was enacted in 1974, and a series of program revisions have followed—the most recent occurring in 2011 (D’Amico and Schochet 2013. TAA provides extended income replacement payments to trade-affected unemployed workers who have exhausted their 26 weeks of regular UI benefits.[32] These income-support

[31]Most of this paragraph was drawn from http://www.ows.doleta.gov/unemploy/disaster.asp.

[32]The Trade Adjustment Assistance (TAA) program was created by the Trade Expansion Act of 1962 (P.L. 87-794) and was substantially modified by the Trade Act of 1974 (P.L. 93-618). NAFTA’s Transitional Adjustment

payments, called Trade Readjustment Allowances (TRAs), are paid at weekly rates equivalent to UI and are available during job search and participation in job-skill retraining. Current durations of TRAs effectively extend UI-like benefits by up to 130 weeks for eligible displaced workers in full-time training and by up to 156 weeks if remedial training is also necessary. The TAA program also provides an allowance for direct job-search expenses of up to $1,500 and an allowance for relocation for reemployment or job search of up to $1,500—the federal employee limit for relocation expenses. Expenses are also paid for participation in job-skill training, which may be full-time or part-time, but full-time training is required for TRA eligibility. An 80 percent tax credit is also provided under the health coverage tax credit (HCTC) for expenses associated with extending health insurance coverage during joblessness, as covered by the TAA program. Certification for TAA is by employer, but displaced workers aged 50 and over may be eligible for Reemployment Trade Adjustment Assistance (RTAA).[33] Participants are eligible for job-skill training support, TRA, and the HCTC. Combined benefits under RTAA are capped at $12,000 over a period of up to two years.

LESSONS FOR A EUROPEAN UNEMPLOYMENT BENEFITS SYSTEM

The United States has more than 80 years of experience operating a multitiered unemployment insurance system. As the European Union (EU) considers developing its own

Assistance program (NAFTA-TAA) was created by the North American Free Trade Agreement Implementation Act (P.L. 103-182).

[33]RTAA is a special wage-supplement program for trade-affected workers aged 50 or older who return to work at jobs paying less than their trade-affected employment. RTAA pays 50 percent of the difference between separation and reemployment wages up to a total of $12,000 over two years. Reemployment must be full-time (at least 35 hours per week) in one or more jobs, or part time (at least 20 hours per week) while also participating in TAA-approved training. Reemployment must not be expected to pay more than $55,000 per year or include a return to the employment from which the worker separated.

multitiered unemployment insurance system, the U.S. experience offers some useful insights for the EU to consider.

Gradual Development

The current multitiered system in the United States differs significantly today from the structure in the 1930s. This is not surprising, of course, given the changes in technology, the economy, and the labor force. Indeed, if anything, we are surprised at how little the system has changed. Two areas where the system has evolved are discussed below—the federal rules for conformity and federal support for states to engage in activities to monitor claimant work-search activity. In addition, states themselves have modified their systems by adjusting benefit amounts and potential durations.

As described above, states are required to meet certain requirements for their UI system to be considered in conformity with federal law. Employers in states that fail to be in conformity do not receive the 90 percent FUTA tax reduction for employers, and the state does not receive federal payments for administrating the state UI system; thus, the conformity provisions include substantial financial pressures for states to meet them. As noted above, the original UI legislation included 12 provisions, and additional requirements have been added over time. The most recent additions have included federal eligibility requirements for extended benefits, requirements for states to establish profiling systems to identify claimants likely to exhaust their benefits, and requirements for states to establish systems allowing beneficiaries to choose federal income-tax withholdings. Interestingly, some of the U.S. conformity changes have been rather minor, such as denying benefits to professional athletes, while others, such as requiring participation in the extended benefits program, have represented major changes to the system. As noted above, in the United States, conformity requirements do not specify rules for setting wage replacement rates or maximum weekly benefit amounts, which as of January 2016 for individual states ranged from $240 to $1,083.

Another example of gradual change in the U.S. system pertains to enhanced efforts to reduce UI payments through increased monitoring and reemployment services. Efforts in this area have included both mandatory activities and voluntary activities. In 1993, states were required to develop and implement Worker Profiling and Reemployment Services (WPRS) systems, which included the use of statistical profiling models to identify claimants likely to exhaust benefits, who were then targeted for mandatory reemployment services. In 2005, the Reemployment and Eligibility Assessment (REA) program was made available to states on a voluntary basis to provide a combination of enforcement actions (eligibility assessment) and reemployment services. The program started with 20 states in 2005, and it has grown to cover nearly all states. In 2015, the program was renamed Reemployment Services and Eligibility Assessments (RESEA), and 44 states and other eligible entities received awards. Under RESEA, states are encouraged to use their WPRS statistical models to target RESEA services on those predicted to be most likely to exhaust benefits. During the Great Recession, all states received large grants to provide reemployment services (RES) to claimants, but these grants were one-time efforts and were not continued.

Approaches to Encouraging Lower-Tier Behavior

Much of the concern in a multitiered system involves principal-agent problems—efforts by the higher-level entity (the federal government) to get the lower tier (the states) to behave in accordance with the higher tier’s wishes. The UI system in the United States has made use of a variety of approaches to influence state behavior: mandates, discretionary grants, and universal grants. The efforts to encourage work-test enforcement and provision of reemployment services to claimants show the mix of approaches that have been tried. The WPRS system instituted in 1993 added worker profiling and the provision of reemployment services to the conformity requirements, making any state that failed to implement the program subject to the loss of the 90 percent FUTA tax reduction. During the Great Recession, the American Recovery and Reinvestment Act of 2009 (ARRA) added $246.9 million for reemployment services for UI claimants, a significant sum compared to the regular Wagner-Peyser Act allocation of $701.9 million and the ARRA general supplement for Wagner-Peyser labor exchange activities of $148.1 million.[34] The REA program, now called RESEA, illustrates a third approach, whereby states are not required to undertake the activities but can apply for the funds to implement the program.

The lesson here is that all three approaches can be effective, but they have different pros and cons. Mandating certain behavior is least expensive to the higher tier but may not be politically feasible, particularly if the lower-tier members have sovereignty and different preferences for policies. The universal funding approach is generally effective in getting the lower-tier members to implement the policy, but the cost to the higher tier is much higher. Finally, the voluntary approach is intermediate in terms of cost to the higher tier, but participation by the lower tier may be limited. This slower response can be advantageous, as in the case of REA/RESEA, where gradual implementation permitted states to try different approaches, and evaluations were conducted to provide more information on the effectiveness of REA/RESEA. The UI Modernization Act, passed during the Great Recession, offers another

[34]While the ARRA funding increases for reemployment services were large relative to baseline levels, it should be noted that U.S. funding for active labor-market programs remains far below levels sufficient to overcome the employment disincentives inherent in UI payment. Martin (2014) reports the average spending on active measures in OECD countries to be 0.65 percent of GDP, which he suggests is nearly sufficient to balance typically generous UI systems. However, the U.S. rate of spending on active measures is low. It was only 0.14 percent of GDP in 2011, a year of relatively high recession-level spending on active measures.

example of the use of financial incentives to encourage states to behave in a particular way; in the modernization program, states could obtain substantial federal funding by adopting specific policies designed to increase the population eligible for UI or provide additional benefits.

Financing Provisions

Financing of the U.S. system is complex, and the structure has both advantages and disadvantages that should be considered by the EU. As was described in more detail above, funds for the UI program in the United States are primarily raised through payroll taxes on employers; the funds are sent to the federal government and most of the money returned to the states that meet conformity requirements. Funds for state administrative functions are financed from the 10 percent federal reserve of FUTA tax revenues. The U.S. approach to UI financing may not be the right strategy for the EU, but it offers some interesting options, which are discussed below.

Payroll taxes have some attractive features for financing unemployment insurance. First, the payroll tax base corresponds well to the benefit principle of taxation, where those who benefit from a government service pay for the service. Second, permitting each state to set its own tax structure permits states to determine how generous their UI system should be while making states bear the consequences of the generosity of their UI benefits. Third, the procedure of relieving employers of 90 percent of the federal tax for conformity gives the federal government considerable leverage over the design of state programs—employers in states out of conformity would be subject to a payroll tax of 6.0 percent rather than 0.6 percent for the FUTA tax. The conformity requirement that states must use experience rating to set any employer's state UI tax rate below the FUTA level is an attractive financing feature, as it gives employers an incentive to make sure that claimants are in compliance with the separation requirements for UI eligibility. One essential principle is to balance benefits and financing. For example, if the maximum benefit amount is indexed to average earnings, then taxable wages should be indexed in a similar way to earnings. This principle of balancing system revenues and expenses should ensure fiscal integrity over business cycles.

There are, however, some financing features of the UI financing structure in the United States that the EU may not find appealing. For example, the FUTA tax base is only $7,000, making the tax a regressive one and providing an incentive for employers to favor high-wage workers in hiring decisions;[35] the low tax base can be justified, at least in part, because UI benefits are not based on all earnings—a sizable proportion of workers earn more than the UI taxable wage maximum. Another unusual feature of the U.S. financing system is that the revenues are obtained through state taxes on employers, which then become part of the federal budget and are rebated to the states. This approach complicates the system and perhaps gives the false impression that the taxes raised by the states are federal in nature; an advantage of the current system is that it makes administration of the trust funds similar across states and facilitates the federal government's ability to make loans to states whose trust-fund balances are inadequate. A final feature of the U.S. financing system that the EU may find troubling is that state administrative costs are distributed to states based on historical cost experience; this approach creates a moral hazard whereby states can increase employee salaries and UI services without bearing the full cost.

[35]Another regressive feature of the U.S. system is that the UI taxes are applied to the "person-job." Thus, a low-wage worker who holds two jobs would have more UI taxes paid in by employers for them than would a person with a higher wage rate but a single employer.

Variations in State Provisions

The UI system in this country permits large variations in state provisions regarding features on the benefits side, such as monetary and nonmonetary eligibility, work test enforcement, benefit size, and benefit duration. The EU might wish to consider the advantages and disadvantages of permitting such large differences. On the tax side, there are variations in the tax base, experience rating, and wages subject to the state payroll tax. For example, the maximum number of weeks of coverage has traditionally been 26, but in 2016 a few states provide a maximum of 13 weeks (Missouri and North Carolina), and Massachusetts provides up to 30 weeks of benefits.[36] The maximum weekly benefit amount ranges from $240 in Arizona to $1,083 in Massachusetts. On the tax side, the payroll tax base is as low as $7,000 annually in three states (Arizona, California, and Florida) and as high as $44,000 in Washington State. State tax rates range from zero in many states up to 11.13 percent in Massachusetts.

Does it make sense to permit such large variation in taxes and benefits? The United States historically has allowed states to vary the generosity of assistance programs; for example, in 2014, the range in state benefits for the Temporary Assistance for Needy Families (TANF) welfare program for a family of three ranged from $170 per month in Mississippi to $923 in Alaska.[37] Large variations in assistance programs might encourage migration to high-payment states. The decision on whether to permit large variations in benefits depends on many factors, including sovereignty of the second-tier entities as well as the extent to which the program is centrally funded.

[36] Data on 2016 UI provisions are from USDOL (2016).

[37] TANF monthly benefit data are from the Urban Institute's 2014 welfare rules database, located at http://anfdata.urban.org/wrd/tables.cfm and retrieved on May 30, 2016.

Redistribution Issues

Redistribution of funds raised can occur within states and across states in the U.S. system. The UI system includes little redistribution across states, as funds raised for UI benefits all come from employers within the state. The exception is for state administrative expenses, where funds are distributed based on historical state experience in staffing and salaries. Within states, there is a greater possibility for redistribution among employers, depending on how well a state's experience rating system corresponds to an employer's experience in laying off workers.

The advantage of the U.S. approach is that each state decides how generous its benefits should be, but the state must be willing to raise enough funding to pay for the benefits. In contrast, the U.S. welfare system includes a substantial amount of redistribution, where wealthier states are required to pay a greater share of program costs than poorer states.[38] A system with substantial redistribution introduces the possibility of "institutional moral hazard," where the second-tier entities have an incentive to provide more benefits than they would be willing to pay for (Vandenbroucke et al. 2016). The EU may wish to have some degree of redistribution—if not, the current system of independent national systems could be maintained.

Crisis Intervention

The United States has established two types of programs to deal with periods of very high unemployment. The extended benefit (EB) program has been in place since 1970; however, it has not been a functioning program in any significant way since 1980. It has been modified a number of times in terms of state and national triggers and benefit provisions, and it is a good program in principle. The idea behind the EB program is to have a permanent program in place

[38]The relationship between federal contributions and state income was clearer before 1997, when the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) froze the federal contribution to the welfare program, TANF, as a block grant. Also, states with lower incomes tend to have lower benefits.

that automatically goes into effect when there is unusually high unemployment. In practice, the EB program has proven to be politically unsustainable. It has been overwhelmed by a discretionary approach that is often used in times of generally high unemployment—i.e., enacting special legislation at the federal level to pay for longer-duration benefits. In the United States, these programs have typically been financed entirely by the federal government, which possibly explains why states have set the parameters of their EB programs so that they are never triggered. Woodbury and Rubin (1997) note there were only six temporary UI extensions between 1970 and 1995. In addition, an emergency program operated from 2002 to 2004 and another, involving several revisions, was adopted during the Great Recession.

The United States has opted to finance the temporary programs with general revenues. Because most states have balanced-budget requirements and the federal government does not, it would be difficult for states to mount new UI programs during a severe recession—a period when state government revenues are stagnant. The EU should consider whether crisis interventions should be implemented in advance, as the EB program in the United States is intended to operate—in an automatic way as crises develop, or as the U.S. temporary discretionary EUC type programs have operated, or both. Other issues to consider are which level or levels of taxation should pay for the program, what the triggering mechanisms would be for EB, and whether the crisis programs should involve changes in the definition of suitable work.

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