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## **Unemployment Insurance Overpayments and Underpayments<sup>1</sup>**

Stephen A. Woodbury<sup>2</sup>

The integrity of the Unemployment Insurance (UI) system has three aspects: whether workers, fraudulently or otherwise, receive more benefits than they are entitled to under the law, whether workers receive less than they are entitled to under the law, and whether employers pay the taxes that they are obligated to pay under the law (Skrable 1999).

UI overpayments have been tracked by the Labor Department since 1987 with the Benefit Accuracy Measurement (BAM) program. As a result, much is known about overpayment of UI benefits (see any of the UI PERFORMS Annual Reports published by the U.S. Department of Labor; for example, U.S. Department of Labor 1998, 1999).

In addition, the Department is now implementing a Denied Claims Accuracy (DCA) program to track the extent to which UI claims are incorrectly (or wrongfully) denied and therefore result in underpayments. To date, the only information on the extent of underpayments from incorrectly denied claims comes from a pilot study that the Department conducted with the cooperation of five states in 1997-98 (Woodbury and Vroman 1999, 2000).

Regarding employer compliance, the Department appears to have no immediate plans to implement a Revenue Quality Control program that would track the degree of compliance with the UI payroll tax. However, information on the extent of employer compliance does exist from a study conducted in Illinois in 1987 (Blakemore, Burgess, Low, and St. Louis 1996; Burgess, Blakemore, and Low 1998; see below).

This testimony focuses on findings about the extent of UI overpayments and underpayments from the five-state DCA pilot study of 1997-98. Combining the DCA pilot data with BAM data from the same states and time period gives a more complete picture of UI overpayments and underpayments—and hence of the UI program's integrity—than BAM alone can give.

### **How the BAM and DCA Programs Work**

Under the BAM program, each state randomly samples a predetermined number of benefit payments each week (between 9 and 35, depending on the size of the state) and investigates each of those payments to determine whether the

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payment was proper. Investigations are performed by telephone and in-person with the claimant, employers, and third parties in order to determine whether the payment complied with the laws and policies of the state. Because BAM randomly samples paid claims, the Department can estimate, on an annual basis, total overpayments in each state and nationally.

In addition to giving estimates of overpayments, BAM yields estimates of the extent of underpayments made *on paid claims*. That is, an investigator may find that a payment was less than it should have been, and this will be recorded and reported. However, BAM has no way of estimating underpayments that result from UI claims that should have been paid but were denied. BAM only samples and investigates UI payments; no payment exists when a claim is denied.

The DCA program fills the main gap in the BAM program by drawing and investigating random samples of UI claims that were denied. A UI claim can be denied for any of three broad reasons:

- The claim may fail to meet the state's **monetary eligibility criteria**; that is, the worker may not have earned enough during roughly the year before claiming benefits. This is a monetary denial.
- The claim may fail to meet the state's **separation eligibility criteria**; that is, the worker may have quit or been discharged for cause rather than being laid off due to lack of work. This is a separation denial.
- The claim may fail to meet the state's **nonseparation eligibility criteria**; that is, the worker may not have been able, available, and searching for work during the week in question. This is a nonseparation denial.

Accordingly, in both the DCA Pilot Project of 1997-98 and the DCA program that is now starting, states drew (or draw) three separate random samples—one of monetary denials, a second of separation denials, and a third of nonseparation denials. Each of these is investigated in a manner similar to that used to investigate paid claims under BAM, and the correctness of the denial is determined.

### **Findings from Five-State Pilot Project**

Table 1 displays UI overpayments and underpayments for 1997-98 in the five states that participated in the DCA Pilot Project—Nebraska, New Jersey, South Carolina, West Virginia, and Wisconsin. These are the only states (and the only time period) for which data exist on the extent of underpayments caused by incorrect denials, in addition to underpayments on paid claims and all types of overpayments.

Column 2 shows that overpayments as a percentage of total UI benefits paid

ranged between 2.2 and 12 percent in the five pilot states, with a weighted average of 7.2 percent in those states. This is slightly below the national average overpayment rate of 8.6 percent. The BAM reports show that the main reasons for these overpayments are (1) workers failing to report all or part of their earnings while claiming benefits, (2) violations of the separation eligibility criteria, and (3) workers failing to search for work as required by state law and policy.

Column 3 shows that underpayments on paid claims (again as a percentage of total UI benefits paid) ranged from 0.5 to 1.2 percent in the five pilot states, with a weighted average of 1.0 percent. This was very close to the national average underpayment rate of 0.9 percent.

Column 4 shows that underpayments caused by wrongful denials ranged from 1.4 to 9.0 percent of total UI benefits paid in the five pilot states, with a weighted average of 3.4 percent. The DCA reports show that wrongful monetary denials account for 39 percent of these underpayments, wrongful separation denials account for 36 percent, and wrongful nonseparation denials account for 25 percent. Also, the underlying causes of underpayments vary with the type of wrongful denial: Employer underreporting of wages is the main cause of wrongful monetary denials; agency error is the main cause of wrongful separation and nonseparation denials.

How closely the five pilot states resemble the rest of the United States in underpayments due to wrongful denials is unknown; however, applying the average rate of underpayments caused by wrongful denials to the entire nation suggests that benefits lost from wrongful denials during fiscal year 1998 were in excess of \$635 million.

Column 5 shows the sum of underpayments on paid claims and underpayments from wrongful denials. A comparison of columns 5 and 2 shows that in one state (Nebraska) underpayments exceed overpayments. In two (West Virginia and Wisconsin) overpayments exceed underpayments by less than 33 percent. In the remaining two states (New Jersey and South Carolina) overpayments exceed underpayments more substantially. In the five pilot states overall, overpayments exceed underpayments by about 64 percent; \$1.00 of underpayment is outmatched by \$1.64 of overpayment. This excess of overpayments relative to underpayments is substantially less than the picture that emerges if one examines only the BAM data, which would suggest that overpayments exceed underpayments by 7 times or more. A view of the UI system's integrity that focuses only on paid claims (as BAM does) and that neglects the accuracy of denials is quite incomplete.

## **Implications**

Because the BAM program samples and investigates only paid claims, BAM offers an incomplete picture of the extent of the UI program's integrity. In particular,

the extent of underpayments cannot be appraised in the BAM program because BAM overlooks the correctness of denied UI claims. A denied claim never generates a payment, so it cannot be sampled under BAM. In effect, incorrectly denied claims slip under BAM's radar. The Labor Department is well aware of this point and is implementing the DCA program to fill the gap.

What can be done to improve the UI program's integrity? The UI system faces an obvious dilemma. Decisions must be made on whether to pay benefits to millions of UI claimants in a timely manner. Too much concern about overpayments is likely to result in states denying benefits to eligible claimants. Too much concern about underpayments is likely to result in states paying claimants who are in fact ineligible.

This dilemma notwithstanding, three policies would clearly improve the soundness and accuracy of the UI program. First, one of the three main reasons for overpayments is a worker's failure to search adequately for work (U.S. Department of Labor 1999). It follows that improved monitoring and enforcement of the work search test would improve the program's integrity. An obvious and direct approach would be to increase the resources available to the states to conduct eligibility review interviews. An alternative would be to expand the Worker Profiling and Reemployment Services System (WPRS), which has existed since 1994. There are good reasons for enforcing the work search test apart from UI program integrity: Available evidence suggests that workers who search more and (as a result) return to work sooner improve both their earnings and their likelihood of staying employed in the long run (Woodbury 2001).

Second, the DCA Pilot Project found that the most common reason for wrongful monetary denials is employer error—meaning essentially that an employer underreported or failed to report a worker's wages (Woodbury and Vroman 1999, 2000). Such underreporting has been documented in an extensive study involving random audits of Illinois employers (Blakemore, Burgess, Low, and St. Louis 1996). That study found that employers underreported the number of workers by over 13 percent and underreported UI taxable wages by over 4 percent. This represents a significant leakage of revenues from the system. Moreover, such underreporting has the effect of increasing the likelihood that workers will be wrongfully denied benefits because employer wage reports are the basis of determining a worker's monetary eligibility for UI benefits. A feasible and well-researched approach to mitigating this problem is to implement audits of firms that are most likely to be out of compliance with the law, as determined by a statistical model (Burgess, Blakemore, and Low 1998). Such a program would require resources, but the evidence suggests that those resources would be recovered several times over as a result of improved enforcement of the UI tax law.

Third, the DCA Pilot Project also found that the most common reason for wrongful separation and nonseparation denials is agency error—meaning an

incorrect decision or action taken by UI personnel (Woodbury and Vroman 1999, 2000). In conducting the DCA Pilot Project, the project's monitors heard repeatedly that it was difficult to attract and retain qualified front-line UI personnel because the work is difficult and the financial rewards meager compared with other available pursuits. But the accuracy of decisions about UI eligibility hinges on the skills, training, and experience of these front-line personnel. If integrity of the UI system is to improve, then more must be done to attract and retain qualified and experienced personnel. A commitment of additional resources for administering the UI system could meet this goal.

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Table 1  
 Unemployment Insurance Overpayments and Underpayments in the Denied Claims Accuracy (DCA) Pilot Project States, 1997-98

<u>State</u>	(1)	(2)	(3)                      (4)		(5)
	Total UI benefits paid (\$1,000s)	Overpayments (as % of UI paid)	Underpayments (as % of UI paid):		Total
			on paid claims	from wrongful denials	
Nebraska	42,472	7.1	0.6	9.0	9.6
New Jersey	1,053,409	6.8	1.2	2.5	3.7
South Carolina	164,376	12.0	0.4	4.0	4.4
West Virginia	126,475	2.2	0.5	1.4	1.9
Wisconsin	465,148	7.9	0.8	5.2	6.0
Five-state total <sup>a</sup>	1,851,879	7.2	1.0	3.4	4.4
U.S. total	18,770,000	8.6	0.9	na	na

Sources: Columns 1, 2, and 3 are drawn from U.S. Department of Labor (1998, 1999). Column 4 is drawn from Woodbury and Vroman (1999, 2000). Column 5 is the sum of columns 3 and 4.

Note:

a. The figures in columns 2, 3, 4, and 5 are averages of the five pilot states, weighted by total UI benefits paid in each state.