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Evidence-Based Reform of the Unemployment Insurance System

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EMPLOYMENT RESEARCH

Evidence-Based Reform of the Unemployment Insurance System

Stephen A. Wandner

ARTICLE HIGHLIGHTS

- *The UI system has not responded to the dramatic changes in the economy.*
- *UI benefits must be adequate to see workers through periods of displacement without forcing them to take a job that does not match their skills.*
- *The most important single change to bring UI benefits and taxes into balance would be to increase the UI taxable wage base and index it to the Social Security wage base.*

The U.S. Unemployment Insurance (UI) system has served jobless workers for nearly 80 years. Even though the U.S. economy, and more specifically its labor force, has changed dramatically during this time, the UI system has changed little.

There is broad consensus that the UI system has not responded to the dramatic changes in the economy. The service-producing sectors of the economy have far outpaced the goods-producing sectors, an increasing share of workers are in part-time, contingent jobs, and many states have not replenished the reserves needed to pay benefits that were depleted during the last recession and are ill-prepared for another economic downturn. All these structural changes call for UI reform but none has been implemented. Rather, the UI system is woefully out of balance and even more so since the Great Recession. States have reduced their duration and level of benefits while not increasing the tax base to finance the needed cash assistance provided by UI benefits.

This article describes the recommendations of several experts on the UI system that are compiled and synthesized in a book recently edited by Dr. Stephen Wandner and published by the W.E. Upjohn Institute for Employment Research, *Unemployment Insurance Reform: Fixing a Broken System* (see p. 7 for more information). The main thrust of this book is the need for comprehensive reform that creates a robust, self-sustaining UI program that restores the ability of the system to reliably provide temporary, adequate income replacement during unemployed workers' search for reemployment. UI reforms should balance benefits and taxes, both in the long term and over a business cycle. UI benefits must be adequate to see workers through periods of displacement without forcing them to take a job that does not match their skills or discouraging them from actively searching for reemployment. In addition, UI taxes need to pay for a robust program of UI benefits, and the

tax burden should be distributed equitably. Finally, the book argues that UI benefits should extend to all workers who are temporarily unemployed, including part-time and other contingent workers.

KEY REFORMS

The contributors to the book offer considerable detail regarding various aspects of the UI system that they firmly believe need reform. This article highlights their comprehensive suggestions for stabilizing the system into the future and for better serving the workers it was established to benefit.

1. Bring benefits and taxes into balance

The UI system today is out of balance. The federal tax base is inadequate, as are many state taxable wage bases. Tax rates are not necessarily adjusted to accommodate adequate benefit payment levels, and benefit levels and maximums are adjusted upward over time in some states but not others. Strategic balancing of UI revenues and benefits has been neglected throughout the program's history at both the state and federal levels. By contrast, Congress has assured that Social Security's benefit levels and taxable wage base keep up with the cost of living. The same should be done with UI. The most important single change to bring UI benefits and taxes into balance would be to increase the UI taxable wage base and index it to the Social Security wage base (see Figure 1 and item 7 below).

2. Regular UI benefits

The basic 26-week UI system must be revised. UI should provide adequate benefit levels and durations as well as reasonable eligibility conditions for workers with past attachment to the labor force before they become unemployed. And the benefit provisions should adapt to the

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substantial changes to the workforce that have occurred in the United States in recent decades.

3. Adequate benefit levels

Given the states' wide discretion to shape their state UI programs, UI benefit provisions vary greatly across the country, and they are likely to continue to do so in the future. This variation is significant enough that it creates substantial equity problems, with unemployed workers receiving widely different duration levels, even after adjusting for state differences in average weekly wages. Because of dramatic differences in the adequacy of state benefit provisions, there have been proponents of federal benefit standards for seven decades. They have concluded that the original proposal from the 1940s is the most reasonable—to set the maximum weekly benefit amount at two-thirds of each state's average weekly wage.

4. Adequate benefit duration

There should be a minimum of 26 weeks of potential duration. From the mid-1970s until 2010, all states had a maximum potential duration of at least 26 weeks, but the spread of lower maximum potential durations over the past few years shows that enacting such a standard is necessary.

5. Eligibility conditions

A few states have significantly narrowed benefit eligibility and harshened benefit administration. States should be encouraged to avoid punitive eligibility conditions that reduce benefit reciprocity below reasonable levels. On the other hand, as a social insurance program, unemployed workers should not be eligible for UI benefits unless they have exhibited recent attachment to the labor force. To achieve this goal, O'Leary and Wandner (Chapter 5) recommend setting eligibility for minimum benefit amounts with high

quarter earnings of at least \$1,000 and second-highest quarter earnings of at least \$500.

6. Adjust other benefit provisions to the changing labor force

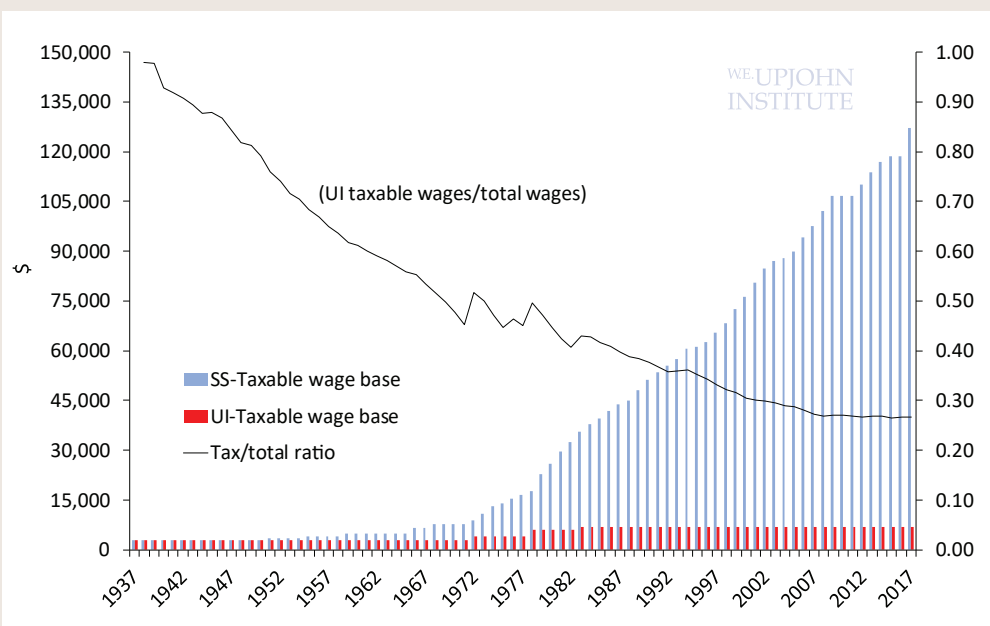
The biggest changes to the workforce over the past two decades have been more multiple earners within households, a long-term increase in the participation of women, and the increased participation of older workers. The UI program could adjust to this modern labor force by implementing the following changes:

- For two-worker families, UI should pay benefits when one spouse follows the other to a new job in a new location.
- The participation of women and older workers has resulted in a sharp increase in part-time work. The UI program should allow unemployed workers to collect UI if they choose to search for part-time work.
- Older workers often must change career jobs or move to jobs that bridge their transition to full retirement. These transitions require job search methods that are different from traditional job searches for similar employment. The transitions also often result in older workers taking bridge jobs that involve a decline in wages, a change in industry and occupation, or a change from full-time to part-time work, so older workers should receive special reemployment services to help with the search for bridge jobs and new careers.
- Because many older workers are continuing to work after leaving their long-term career jobs, the federal pension offset provision should be eliminated.

7. Adequate, equitable funding

Today, low-wage employers pay a disproportionate share of UI taxes. They may pay UI taxes on all or nearly

Figure 1 UI and Social Security Taxable Wage Bases and the Ratio of Total to UI Taxable Wages, 1937–2017



SOURCE: U.S. Department of Labor, Unemployment Insurance Financial Data: Employment and Training Handbook No. 394, <http://ows.doleta.gov/unemploy/hb394.asp> (accessed October 23, 2018); annual taxable wage base for Social Security from the Social Security Association and Internal Revenue Service.

all of their wages paid, while high-wage employers may pay taxes on only a small portion of their wage bill.

- A higher taxable wage base is needed to spread the burden among low- and high-wage employers, as well as to raise adequate revenue to support the UI system.
- The UI taxable wage base must increase considerably, such that it equals between one-third and one-half of the Social Security taxable wage base. It should also be indexed each year to increase at the same percentage rate as the Social Security taxable wage base. Alternatively, the UI taxable wage base could be tied to the average wage in covered UI employment rather than to the Social Security wage base.
- To have a sound UI tax system, state tax schedules should be set such that no state is permitted to include a zero rate in any tax schedule so that all employers support the UI system's operating costs and each tax schedule includes at least 10 rates so that all employers pay UI taxes closely reflecting their unemployment experience.
- Employers tend to oppose increases in UI benefits and taxes because they pay the entire tax. UI research, however, indicates that the incidence of the UI tax falls, in large part, on workers through reductions in their total compensation—that is, wages plus benefits. The UI tax should change from an employer tax to a joint employer-employee tax, with employees paying half or more of the tax so that employees have increased ownership in the UI program.

8. Countercyclical funding

During economic downturns, the UI system has greater demand for benefits and receives less revenue than it does during periods of expansion. To have a countercyclical financing system, forward funding is needed.

- The UI Trust Fund should have adequate reserves before a recession begins. UI taxes should not increase at the beginning of a recession. Rather, state accounts in the UI Trust Fund should be restored after a recession is over and before the next recession begins.
- States should adhere to the appropriate tax schedule under their state law, without any legislative deferral of movement to higher schedules, subject to the loss of UI offset credits. State tax schedules should be selected annually based on maintaining or achieving adequate state system reserves.
- U.S. Department of Labor reserve requirements should guide states in attaining reserve adequacy. Building an adequate trust fund can be facilitated by either requiring states to reach an adequate level of reserves or by providing states with a financial incentive for building their reserves to a specified level. Both approaches have been recommended by UI reform proposals, and both would improve system solvency.

9. Administrative financing

The administration of the UI, Employment Service (ES), and other federal-state labor market programs is funded from the Federal Unemployment Tax Act portion of the UI tax. Federal funding pays for program administration, extended benefits, and loans to states—each with its own account. States have faced severe funding problems in the administration of these programs for many years, and it has become even worse over time. The balances in the federal accounts have been inadequate, and Congress has appropriated a declining percentage of the tax revenues that are deposited into the administrative account. Congress should fully fund UI and ES administration. Appropriation levels for UI should fully reflect benefit payment,

benefit integrity, and tax collection costs. The levels for ES should be greatly increased, bringing appropriations back to the 1984 level in real terms—a time when ES funding was more adequate.

10. Extended benefits

Although Congress will always want to have the final say about benefit duration extensions during recessions, it often is slow to act. The United States needs an automatic system of benefit extensions that works in a timely fashion.

- Extended benefits (EB) are not insurable and consequently cannot be financed as if they were. Rather, they should not be treated like the regular 26-week program but should be funded from general federal revenues, either from the UI Trust Fund or from general revenue.
- Existing EB triggers should be replaced with a new trigger mechanism that uses the total unemployment rate rather than the insured unemployment rate. More specifically, recent EB program proposals reviewed in the book call for improving the EB trigger mechanism by making use of the total unemployment rate and having multiple levels of EB durations from 7 to 54 weeks. In addition, the number of weeks of EB should vary with the unemployment rate, so that EB is sensitive to the severity of recessions.

11. The work test and reemployment services

The work test is crucial for having the UI program remain as a social insurance program. ES and UI programs provide the work test under federal law, ensuring that UI recipients are able, available, and actively searching for work. Reemployment services also refer UI recipients to jobs and provides them with labor market information. These services are critical in a world with few temporary layoffs and many permanently displaced

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unemployed workers. Job search assistance and other reemployment services programs have been shown to be highly cost-effective in promoting return to work and in shortening durations of UI benefit receipt.

- The UI and ES programs need sufficient funding to provide displaced workers with intensive, in-person job search assistance.
- Funding of reemployment services—under both the Wagner-Peyser Act and the Workforce Innovation and Opportunity Act—should be increased, with Wagner-Peyser Act funding restored to its 1984 level in real terms.
- Other reemployment and unemployment prevention services can speed the return to work of UI recipients by expanding the use of short-time compensation and self-employment assistance programs, and by enacting a program of targeted reemployment bonuses.

CONCLUSION

Public policy regarding the UI program has been neglected for many decades. Much of the program is broken and requires major reform now. Both states and the federal government should adopt policies and enact legislation that can restore the program, consistent with its original intent. Otherwise, the system will be inadequate in the future, particularly when it is needed during the next recession. The changing nature of the workforce requires that the UI system provide adequate benefits to every worker while remaining financially solvent to ensure a competitive economy and a well-functioning workforce.

Stephen A. Wandner is a Research Fellow at the W.E. Upjohn Institute for Employment Research, a Non-Resident Fellow at the Urban Institute, and a Senior Fellow at the National Academy of Social Insurance.

Why Do Wages Differ across Businesses within the Same Labor Market?

Eliza C. Forsythe

The idea that wages can differ across businesses in the same market seems contrary to basic economic theory. Yet, we find that wages do differ across establishments. Looking at the service sector—which has grown steadily for decades in numbers and as a share of total U.S. employment but pays less than most other major sectors—I find great variation in wages paid to workers at the lowest end of the pay scale. More specifically, the bottom 10 percent of establishments pay wages below \$8.07 per hour to employees in their lowest decile of wages, while the top 10 percent of establishments pay wages above \$21.14 to employees in their lowest decile. I also find that establishments that pay low wages to those workers in the lowest decile of the wage distribution within an establishment also pay low wages throughout the pay scale.

The heterogeneity of wages across establishments is important not only to explain why wages differ in single labor markets but also to help understand the implications of various public policies such as minimum wage legislation. For example, minimum wage legislation that requires wages to be above \$10 an hour will have no

effect on establishments that pay their lowest paid workers \$21 an hour, while it could have significant effects on establishments that pay their lowest paid workers only \$8 an hour. I find that even in the service sector, in which a substantial fraction of employees is paid close to statutory minimum wage, there is substantial variation in wages across establishments in which some are not impinged by such a wage floor.

Previous research on wage heterogeneity between firms has found that wages vary by firm size, with larger firms paying more than smaller firms, even within the same industry. Several studies have also found that establishments within the same industry adopt different management and production technologies, which can lead to differences in productivity with the understanding that more productive firms can pay higher wages. I contribute to this literature by examining the wage and occupational structure for service sector establishments in the United States in 2016.

Methodology

This article describes results from my recent study and working paper, “The Occupational Structures of

ARTICLE HIGHLIGHTS

- *Establishments within narrowly defined industries and within the same local labor market pay different wages.*
- *These establishments differ significantly in their occupational structure, which indicates that apparently similar establishments can differ substantially by production process yet still compete in the same market.*
- *The variation in wages and occupational structures suggests that public policies such as minimum wage may affect workers differently, even within the same industry and labor market.*