Fraud, Abuse, and Errors in the Unemployment Insurance System: Extent, Measurement, and Correction

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Citation
CHAPTER 10

Fraud, Abuse, and Errors in the Unemployment Insurance System
Extent, Measurement, and Correction

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This chapter examines the extent of financial losses or leakages in the federal-state system of unemployment insurance (UI) in the United States. "Leakages" or "losses" will be used interchangeably to refer to funds due the UI system that it failed to receive, benefits wrongly paid out, and other resources lost. Where possible, the chapter attempts to distinguish losses resulting from intentional (fraudulent) actions by claimants, employers and UI agency staff from those occurring for nonfraudulent reasons.

The UI system is a major social insurance program in the United States. In fiscal year (FY) 1995, a year of relatively low unemployment, total UI program benefit payments amounted to $21 billion, state tax collections (contributions) were $23 billion, federal collections for various federal and federal-state extended benefit programs and administration were $5.5 billion, and allocations to state employment security agencies (SESAs) for administration were $3.6 billion. Due to the size and complexity of the system, the incentives facing claimants and employers, and the limited administrative funding available to enforce compliance, the UI system contains many areas of opportunity for the inappropriate use of funds. Policy makers, as well as other stakeholders in the system, want to know the causes of errors and misuses as well as the scale of fraud and abuse, so that these problems can be minimized.

In a discussion of the loss of funds from a social insurance system due to error or fraud, the legal and economic views are related but not
identical, and both are of interest. The law’s main concern is whether
the losses are fraudulent or erroneous. Legally, the question is the fol-
lowing: did the person willfully or intentionally misrepresent facts
affecting benefit eligibility or tax liability? Although state laws vary
considerably in whether any given action involving the UI system
involves fraud, all states have much more severe penalties and can
exercise a greater variety of recovery options in the case of fraud. The
range of state fraud laws must be kept in mind whenever a national
estimate of “UI fraud” is offered.

The economic view is broader and concerned more with knowing
why payment errors occur so that they can be prevented. Economists
also want to know the size of errors, so that the costs and benefits of
prevention or recovery strategies can be determined. Economists tend
toward a threefold classification of overpayments. First, there are small
random mistakes due to inadvertence by both UI staff and claimants or
employers. Second, in complex programs such as UI, characterized by
many involved provisions for benefit eligibility and tax liability, the
range of errors due to lack of knowledge or the time to make thorough
determinations is considerable. Such errors would be systematically
related to the complexity of the program but can be reduced by better
training of staff, systematizing procedures, and educating claimants
and employers. Third, some claimants and employers will intentionally
cheat. Economists go beyond merely calling this “fraud” to analyzing
the extent to which the system provides incentives and disincentives
for such behavior. They reason that certain individuals weigh the bene-
fits of cheating against its “cost” in terms of the likelihood of being
detected and the penalty they face if caught and act accordingly to
maximize their incomes. In the case of UI, the balance of incentives
certainly appears to favor fraudulent behavior. The rules are complex.
Claimants and employers provide crucial information that is expensive
to verify. Administrative budgets to process tax and benefit actions are
spare. Because of the desire to ensure customer service and to meet
promptness standards, timeliness has been emphasized over accuracy.
Thus, the chance of detection is low. Penalties are relatively light in
most cases.¹

This chapter is organized around a description of the major UI
resource flows, since these constitute the potential sources for misuse
through errors and fraud. At each critical point in the review, the size of
the basic funding flow is identified, and the potential for leakage at the point is explained. If leakages at that point are regularly measured by the current system of monitoring, current practice is described, and a brief historical sketch is provided of the development of the present measurement or assessment approach. The most recent estimate of leakages at that point will also be given, along with what has been done or is being done to stanch the outflows, recover overpayments, or collect outstanding debts.

The chapter concludes with a discussion of some technical issues and measurement gaps. The main ones involve measuring: (1) the extent to which current estimates from the Benefits Quality Control (BQC) program of dollar overpayments actually represent true dollar losses to the UI system, (2) the accuracy of claims denial decisions, and (3) the degree to which employers comply with contributions (payroll tax) laws.

**Major Financial and Information Flows in the Unemployment Insurance System**

Figure 10.1 outlines the principal financial and information flows that characterize the UI system. In nearly all cases, each financial flow is accompanied by a counterflowing stream of information from claimants and employers. Very often, the information is essential to determining the proper size of the corresponding financial flow. In fact, the opportunity for fraud or other abuse often arises from the fact that the beneficiary or taxpayer controls the information. This is the essential moral hazard problem in principal-agent relations. The six important flows depicted in figure 10.1 are each described in the following subsections.

**The Benefits Flow**

In the UI process, the state employment security agency (SESA) obtains information from individuals when they file an initial or continued claim for benefits. This is combined with data from employers on the person's base-period earnings and/or weeks of work and reason for
Figure 10.1 Major Financial and Information Flows in the United States Unemployment Insurance System

UI Trust Fund Accounts of the U.S. Treasury

Federal Unemployment Tax Act (FUTA) accounts

Unemployment Trust Fund

(3) FUTA revenues

(4) Administrative grant money

Employer sector

Information on UI tax rates

(2) Data on eligibility and contributions

Benefit payment account

Clearing account

(6) State bank accounts

Money for UI benefits

Money from state UI taxes

(1) UI benefit payments

(5) State employment security agencies

Information for UI benefit certifications

(1) UI benefit payments

(6) State bank accounts

Money for UI benefits

Money from state UI taxes

Unemployed persons and persons out of the labor force
separation. Together, this material allows the SESA to determine initial monetary and nonmonetary eligibility for UI benefits and subsequently to make benefit payments. In fourteen of the past twenty-five years, benefit payments were the largest financial flow in the UI system. In calendar year (CY) 1994, the UI benefit payment outflow was approximately $22.6 billion. Benefit payments included the following main components:

- Regular state UI $21,657 billion
- Federal-state extended 0.220
- Ex-Federal Employees (UCFE) 0.275
- Ex-Servicemembers (UCX) 0.347
- Disaster Unemployment Assistance 0.114
- Trade Readjustment Allowances 0.130
Total $22.743 billion

State Contributions and Reimbursements

Over 98 percent of the 6 million employing units covered by the system are subject to UI payroll tax contributions and are referred to as "contributory employers." They make quarterly contributions (tax payments) to the UI trust fund based on their taxable quarterly wages and their SESA-determined tax rate. Most employer tax rates are experience rated: after a lag of one to three years, depending on the state, the UI tax rates of employers reflect the benefits paid to their former employees. For purposes of UI financing, the remaining 2 percent of UI-covered employers are referred to as reimbursing employers. This group includes mostly state and local governmental units and nonprofit agencies. From the standpoint of UI, these employers are self-insured; they repay benefit charges dollar-for-dollar and are not subject to a state experience-rating tax scheme.

In CY 1994, the sources of funds were as follows:

- State Contributions $21.975 billion
- State Reimbursements 1.140
Total $23.115 billion
Federal Unemployment Tax Act Revenues

In addition to making state UI tax payments, contributory employers remit a flat federal tax on wages paid to each employee. This tax, paid to the IRS, is 0.8 percent of annual wages up to the maximum of the federal taxable wage base, presently set at $7,000 per calendar year. These collections were approximately $5.5 billion in FY 1995. The revenue is apportioned by formula among the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), and the Federal Unemployment Account (FUA). (See the appendix to chapter 8.) In FY 1995, 85 percent of Federal Unemployment Tax Act (FUTA) revenue went to the ESAA.

Administrative Grants

From the ESSA, the federal government provides grants to states to administer the state and federal unemployment compensation programs, the Employment Service (ES), and the Veterans Employment and Training Service (VETS). The UI administrative grants are tied to the UI workload—benefit payment and tax collection activities. Each quarter, states receive a formula-driven base amount to fund their continuing program level. If their workload exceeds a certain amount, they may also claim additional contingency funding. In FY 1995, these costs amounted to $3.6 billion:

- State UI $2.3 billion
- Federal programs 0.2
- ES, VETS 1.1

UI Administration

As listed, in FY 1995 SESAs received $2.3 billion to administer their state UI programs and another $200 million to administer federal unemployment compensation programs. There is potential for fraudulent state use of funds allocated to pay for administration.
Trust Fund Operations

As noted, in FY 1995 the federal-state UI system collected some $23 billion from employers and paid out roughly the same amount in benefits to claimants. Money deposited to and withdrawn from the Unemployment Trust Fund (UTF) accounts at the U.S. Treasury passes through state bank accounts called the UI Clearing Account on the way to the Treasury and the UI Benefit Payment Account on the way from the Treasury. Although states are legally required to deposit employer contributions and other monies for the unemployment fund (e.g., benefit overpayment recoveries) and any interest earnings on those funds into the UTF, state treasurers and banks have an obvious financial motive for leaving unemployment funds in state bank accounts as long as possible, to defray bank charges through earnings on compensating balances.

The following sections describe the main risks of financial loss that may be encountered because of fraud or errors at each of the six points that have been summarized. Also reviewed is how the federal-state UI system now attempts to assess the risks and to measure the losses. A brief history of the development of the assessment approach is given, together with recent estimates of losses. The summary and conclusions section reviews how data have been used to prevent future losses and suggests further steps that might be taken.

Types of Benefit Payment Errors

UI provides temporary, partial wage replacement as a matter of right to involuntarily unemployed workers with substantial attachment to the labor force. States evaluate labor force attachment by reviewing the extent of work and/or earnings in a twelve-month base period preceding the application for unemployment benefits. Furthermore, states closely scrutinize reasons for separation from work, as well as the claimant’s continuing ability, availability, and degree of active work-search to ensure that the claimant is truly unemployed and not actually out of the labor force.
Determining UI eligibility thus involves tests at three levels: (1) monetary, (2) separation, and (3) continuing eligibility. Risks for wrong payments or payments to ineligible persons exist at all stages. The common thread linking these risks is that of moral hazard: potential beneficiaries supply some of the information needed to determine benefit eligibility and therefore have the ability to withhold critical facts. Realities of time and cost force the UI system to accept information provided by claimants and employers as valid, especially in the short term. This leaves the system open to many risks of improper payment. The following reviews the main risks at each eligibility level.

**Losses Based on Monetary Eligibility**

In all but two states, monetary eligibility is determined through examining computerized agency wage record data. These data are also used to set the weekly benefit amount for claimants deemed monetarily eligible. There are two main kinds of risks.

- A fictitious employer is an imaginary enterprise that establishes an employer account with the SESA. It submits bogus wage records for imaginary employees on whom it initially pays UI taxes. The ostensibly laid-off workers then file claims based on those fictitious wage payments. This practice is clear and intentional fraud.

- Routine monetary errors due to inaccurately maintained and/or submitted payroll data by employers are numerous. Most cause small dollar mistakes in claimants’ weekly benefit amounts, but when added together they are important sources of error, and both underpayments and overpayments from this source probably exceed fictitious employer losses. In the aggregate, base-period wage errors tend to result in just about the same dollars overpaid as underpaid.

**Losses Due to Separation Violations**

Claimants must have been separated from work through no fault of their own. Such separations include various categories of quits for good cause and discharges without cause. In six states, even claimants who quit or were discharged for disqualifying reasons become eligible for UI benefits if they remain unemployed long enough. The main type
of fraud under this category occurs when claimants who quit or were legitimately discharged for improper workplace behavior file for benefits alleging “lack of work” and their claims go unchallenged by their separating employer.

**Leakages Due to Continuing Eligibility Violations**

Claimants must be able, available, and actively seeking work, and may not refuse an offer of suitable work during each period of unemployment claimed (usually one week). States consider refusal of suitable work to be the most serious of these violations and typically penalize it by stopping benefits for the remainder of the benefit year and canceling wage credits. In practice, this seems to happen infrequently. Most continuing eligibility violations occur because claimants are unable to work or are unavailable for the week claimed, fail to make a proper search for work, or fail to meet the test of being unemployed because of excess earnings or other income. The claimants then either fail to inform the agency that they have not met the eligibility conditions or consciously give wrong information. In the broadest sense, the latter is fraudulent behavior, although, depending on the state, much of it may not be considered fraud.

**Measurement and Detection of Benefit Payment Errors**

The UI program has two principal kinds of systems for identifying, estimating, and/or detecting improper benefit payments. These are: (1) Benefit Payment Control (BPC) activities and systems, designed to detect and deter fictitious employers and individuals who have disqualifying income while in claims status and, where feasible, to recover overpaid amounts; and (2) the Benefits Quality Control (BQC) program, a sample-based system for estimating the extent and nature of improper payments so that deficient processes may be improved.

**Benefit Payment Control**

All detection and recovery systems come under the common rubric of BPC. The systems attempt to detect specific instances of error and
abuse, and, where the dollar amount involved is large enough to justify the cost of pursuit, to initiate recovery procedures. SESAs are encouraged to publicize prosecutions for fraud widely to discourage others from engaging in such practices.

*Systems for Fictitious Employers*

For some twenty years, there has been continuing concern about detecting—and, more importantly, preventing—the various kinds of fictitious employer schemes that could defraud the UI system of massive sums. The mainstay is the Fictitious Employer Detection System (FEDS). It comprises two subsystems. The New Employer/Employee Tracking System (NETS) uses data in SESA records to determine within 15 weeks of a claim being filed against a new account whether that account is legitimate. The Legitimate Employer Claims Analysis System (LECAS) identifies for review employers engaging in certain suspicious claims patterns, e.g., both the employer and claimant addresses were post office boxes.

Because of the age of the FEDS systems, administrators in some states believe that sophisticated thieves have identified ways of avoiding detection. Other techniques to spot fictitious employers and similar, fictitious claims include monitoring and following up on frequent claimant address changes, looking for multiple UI benefit checks mailed to a single address, verifying that claimants are not ineligible illegal aliens through the Systematic Alien Verification for Entitlement (SAVE) program, and using the Enumeration Verification System (EVS) to identify persons filing claims with other than their own social security numbers.

*Systems for Detecting Disqualifying Income*

The BPC system also includes mechanisms designed to detect disqualifying income. A person with more than a certain amount of income in a week, whether from earnings or most other sources, is ineligible for a UI benefit that week. The most significant type of tool used for detection is the crossmatch and postaudit. To find claimants with disqualifying earnings within their states, most SESAs use the Model Crossmatch system, a computer match of the prior six months of claimant records with employer wage records. Five states use the more extensive Benefit Audit, Reporting, and Tracking System (BARTS), which
allows a full one-year match. Nearly all states use a similar crossmatch, called the Interstate Crossmatch/Claimant Locator, each quarter to detect individuals making claims in one state while working in another. It also allows them to locate persons with outstanding overpayment balances who have left the state. Because they rely on wage records, these crossmatches can detect only private sector work. Depending on their laws and economies, some states use similar crossmatches to detect ineligible workers in government jobs, including federal, state, county, municipal, National Guard, and the military reserves.

All crossmatching systems first detect potential violators, then apply variable dollar screens to indicate those with the greatest recovery potential. BPC staff verify week-by-week earnings of the indicated claimants with employers. The last step is to audit claimants and to set up overpayments for recovery as warranted.

**Other Crossmatches**

States have at their disposal a variety of other systems that use crossmatching to detect specific types of disqualifying income or disqualifying conditions. There are social security, workers' compensation, and Railroad Retirement crossmatch systems for disqualifying income. Some states also review or match prison data, death records, Job Service hires, and special employer new-hire reports to detect other disqualifying conditions.

**Less Systematic Approaches**

BPC also relies on tips, referrals, and border checks to obtain allegations of fraud and abuse. Staff follow up with audits or investigations.

**Estimating the Extent of Improper Payments: The Benefits Quality Control Program**

The Benefits Quality Control (BQC) program is a system in place since 1987 to estimate the extent, kind, causes and responsibilities of dollars overpaid by the federal-state UI system. BQC also provides estimates of the dollar value of underpayments. Its design evolved in three main stages.

In the late 1970s, the UI Service developed measures of initial and continued claims accuracy as part of the Performance Standards
Project. Between 200 and 300 randomly sampled claimants were interviewed about both initial and continued claims activities in a review "designed to establish that the SESA made proper payments with the information that was available or which could have been obtained by utilizing proper interviewing techniques" (U.S. Department of Labor 1976-1977, p. II-8). Measures of initial and continued claims performance became part of the UI Quality Appraisal system for assessing program performance but were not used to estimate dollars overpaid or underpaid.

In 1979, the National Commission on Unemployment Compensation (NCUC) funded a pilot test in six cities of a new approach to determining payment accuracy. Randomly selected samples of UI benefits were thoroughly analyzed for accuracy to estimate the "true" level of improper payments. The examination included in-person contacts with the claimant, employers, and third parties to verify pertinent information. The investigation also involved a postaudit, similar to the current BPC crossmatch, to detect earnings during the claim period. This study estimated overpayments at several times the rate BPC detected. The U.S. Department of Labor then funded a replication of this random audit (RA) study in five states. When statewide findings confirmed the results obtained in the pilot study conducted in cities, the Department of Labor began extending RA to other states. By 1984, forty-six states were conducting random audit investigations, each on a minimum of 400 sampled cases per year. Estimated overpayments averaged about 12 percent of benefits, implying some $1.5 billion overpaid for the system at the time.

In 1983, in response to overpayment issues raised by the U.S. Department of Labor Inspector General in connection with RA findings, the department convened an interagency Benefit Payment Oversight Committee. The committee recommended that the department establish a formal BQC system. The BQC program was phased in voluntarily and became mandatory in 1987. Its methodology was adapted from RA experience. However, BQC sample sizes were larger and varied by size of state to enable more precise estimates of error types and causes. BQC also adopted an explicit commitment to using the data for program improvement and compiled a more extensive record on each case sampled for this purpose.
Since 1987, all SESAs except the Virgin Islands have been required by regulation to operate BQC programs to assess the accuracy of their UI benefit payments. The BQC programs operate as follows: each state draws a weekly sample of payments. Annual samples presently average slightly over 800 cases per state, with a range of 480 to 1,800. A specially trained staff reviews SESA records and contacts the claimant, employers, and third parties to verify all the information pertinent to the benefit amount for the sampled week. Initially, all verifications were done in person. Since July 1993, after a pilot test showed that certain aspects of claims could be verified more efficiently with little loss of thoroughness by telephone, investigators have been allowed to use a mix of in-person and telephone/fax contacts. Using the verified information, investigators determine what the benefit payment should have been to accord fully with state law and policy. Any differences between the actual and reconstructed amount are underpayment or overpayment errors and are recorded in a specially provided computer along with their types, causes, and responsibilities. This information is used to estimate the extent of improper payments in the state to guide possible future program improvements. In FY 1995, states received approximately $26 million to operate the BQC program.

Estimated and Detected Overpayments

Table 10.1 presents data on estimated and detected benefit overpayments during CY 1994. The BQC estimate covered a $21.2 billion universe—some 93 percent of all benefit payments, with interstate benefits the main area outside its review. In the aggregate, approximately $1.82 billion, or 8.6 percent, was overpaid. State overpayment rates ranged from 1.9 percent to 17.7 percent. About 11 percent of BQC-detected overpayments occurred at the monetary determination level, 16 percent resulted from separation decisions, and the remaining 73 percent were due to various continuing eligibility violations. Of the eligibility violations, excess earnings during the benefit period and other failures to maintain eligibility, principally neglecting to register with the Job Service, were most important. Overpayments classified as fraud totaled an estimated $390 million (not shown in table).
Table 10.1 Fiscal year and Calendar Year 1994 Estimated and Detected Leakages by Source ($millions)

<table>
<thead>
<tr>
<th>Source Description</th>
<th>Estimated</th>
<th>Detected</th>
<th>Recovered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Benefit payments</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Monetary eligibility</td>
<td>$1,820</td>
<td>$543</td>
<td>$257</td>
</tr>
<tr>
<td>a. Fictitious employers</td>
<td>201</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2. Separation</td>
<td>294</td>
<td>10</td>
<td>NA</td>
</tr>
<tr>
<td>3. Continuing eligibility</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>a. Work search</td>
<td>321</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>b. Other (fail to register)</td>
<td>431</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>c. Benefit yr. earnings</td>
<td>437</td>
<td>173</td>
<td>NA</td>
</tr>
<tr>
<td>d. Other disqualifying income</td>
<td>137</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>4. Not attributable to stage of eligibility determination</td>
<td>---</td>
<td>354</td>
<td>257</td>
</tr>
<tr>
<td><strong>B. Contributions and reimbursements</strong></td>
<td>935</td>
<td>311</td>
<td>53</td>
</tr>
<tr>
<td>1. Tax rate errors</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2. Underreported contributions</td>
<td>935</td>
<td>53</td>
<td>53</td>
</tr>
<tr>
<td>3. Hidden employers</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>4. Uncollected receivables</td>
<td>NA</td>
<td>258</td>
<td>NA</td>
</tr>
<tr>
<td><strong>C. FUTA tax payments</strong></td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td><strong>D. Administrative fund allocations</strong></td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1. Overstated workload</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td><strong>E. Agency administrative operations</strong></td>
<td>0.7</td>
<td>1.0</td>
<td>NA</td>
</tr>
<tr>
<td>UI staff losses involving:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Benefits</td>
<td>0.3</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>2. Contributions</td>
<td>0.3</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>3. Administrative funds</td>
<td>0.1</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td><strong>F. Trust fund operations</strong></td>
<td>4.6</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1. Clearing account</td>
<td>4.6</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>2. Benefit payment account</td>
<td>NA</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td><strong>G. Total—all sources</strong></td>
<td>$2,760</td>
<td>$855</td>
<td>$310</td>
</tr>
</tbody>
</table>

**NOTE** NA = not available
For the same time period, BPC activities identified $543 million in actual overpayments potentially subject to recovery, of which $220 million constituted fraud. Since BQC and BPC report data in somewhat different formats, and the methods used to detect 58 percent of overpayments ($312 million) were not specified, it is not possible to provide the same breakdowns of data on estimated, detected, and recovered overpayments. It may be presumed that most of BPC detections involve excess earnings and other income during the benefit year, the aggregate of which BQC estimated at $574 million in 1994. Fictitious employer detections were $6 million, and overpayments identified through employer protests (mostly involving reason for separation) were only $10 million.

Types of Errors in Employer Contributions

UI contributing employers pay a quarterly tax on the wages (up to the state’s annual maximum wage base) of their covered employees. Typically, they receive a quarterly form containing their tax rate from the SESA. Employers report total and taxable wages of employees paid during the quarter on this form, and return it with the tax payment due. Annual earnings exceed the taxable wage base for most workers. In 1994, earnings taxable for UI amounted to only 36.2 percent of all wages paid to workers covered by the UI system. For these taxable wages, the main sources of losses in contributions have been (1) errors in the tax rate, (2) underreported employees or wages per employee, (3) hidden employers, and (4) unpaid or uncollected contributions due.

Errors in the Tax Rate

The fifty-three UI jurisdictions each use one of four basic experience-rating approaches. The actual rate formulas can be very involved. Complexities increase when firms merge or hire workers through employee-leasing companies. The U.S. Department of Labor presently has no data on the extent of errors in experience-rated taxes or on the degree to which such mistakes might cancel one another out in the aggregate. A recent internal security panel did, however, identify tax
rate errors as a major UI risk area. Procedures implemented in 1996 to assess the quality of tax operations will judge tax rate accuracy. The approach adopted involves evaluating the SESA's controls designed to ensure tax rate accuracy and determining whether these are operative by drawing a small (60 accounts) acceptance sample. However, the acceptance sample is not designed to yield an estimate of tax rate errors.

**Underreported Employees and Wages**

Since early in the history of the federal-state UI program, SESAs have been required to audit covered employers. The Quality Appraisal system set a Desired Level of Achievement (DLA) for the fraction of employers audited each year. Remaining at 4 percent for many years, it was recently reduced to 2 percent when audit quality standards were tightened. Similar to BPC operations, these audits were principally designed as an efficient means of ensuring compliance with UI laws and timely collection of taxes. During CY 1994, SESAs audited 129,000 firms, identifying $53 million in underreported contributions and $8 million in overreported contributions.

Although existing field audits tend to be cost-effective, SESAs select firms for audit in many ways; none of them permit states to estimate the extent of underreporting as BQC does for benefit overpayments. Estimating underreporting has, however, been considered by the U.S. Department of Labor and remains under consideration. A model for this approach has been tried. In 1989, Illinois estimated 1987 employer compliance by carefully auditing 875 randomly selected firms. Nearly 45 percent of firms had some underreporting error; 13.6 percent of employees were unreported, with most of them having been misclassified as independent contractors. The researchers who conducted the project estimated that covered wages were underreported by $1.18 billion (4.2 percent) and contributions by $45 million. Although it was a one-time sample and included only firms headquartered in Illinois, the authors nevertheless concluded that “since reporting requirements as well as noncompliance detection probabilities and penalties in Illinois are typical of those in other states” the findings may have national applicability. An underreporting rate of 4.2 percent for tax-
able wages, at the 2.6 percent U.S. average tax rate in 1994, implies leakages of about $935 million.

**Hidden Employers**

SESAs routinely pursue many avenues to identify firms that choose not to register. These include scanning yellow page listings, reviewing business license lists and other tax filings, and conducting additional forms of outreach. Many employers are only spotted when claimants file for benefits and the agency has no wage records: these are called *blocked claims*. There are no estimates of the potential number of hidden employers.

**Unpaid Tax Liabilities**

Each quarter, about 11 percent of employers provide late wage reports and tax payments or fail to report at all. At the end of CY 1994, the states had about $1.8 billion in due but uncollected UI taxes. As a rule of thumb, most amounts not collected within 15 months will not be obtained. At the end of 1994, uncollected taxes of $1.37 billion were at least 15 months old. The bulk of receivables remains in SESA accounts due to state laws that prohibit removal regardless of age. (Some indebtedness can be as much as fifty years old.) In 1994, states accrued $2.264 billion in new accounts determined receivable (ADR), and collected (liquidated) $2.007 billion, a difference of $257 million. Also during that year, they wrote off $239 million as uncollectible, so total amounts due grew by only $18 million. It must be noted that ADRs, write-offs and liquidations relate to different time periods. Most ADRs are terminated within a quarter or two, but some liquidations and most write-offs pertain to receivables established years earlier.

**Federal Taxes**

How well the conclusions of the previous section apply to FUTA payments is not known. The two taxes have one major difference: the FUTA tax is not experience rated, and thus fewer rate errors should be involved. Most employers pay a net FUTA tax rate of 0.8 percent of
each employee’s first $7,000 in annual wages. It should also be noted that the FUTA tax base of $7,000 applies to the earnings of all workers. By contrast, in 1994, thirty-nine states had higher taxable wage bases for determining their state UI tax, ranging up to $25,500 in Hawaii.

Administrative Grants

The U.S. Department of Labor provides SESAs with funds for UI administration based on forecasts of workload (benefit payment and tax collection activities). After a completed quarter, states determine whether their workload was high enough to have earned their projected funds. If the workload exceeded the amount needed to fund the base allocation, states may be entitled to additional contingency funds. Fund claims are based on a series of key “workload items,” such as initial and continued claims taken, nonmonetary determinations made, number of subject employers, and lower authority appeals. The risk of funding misuse arises mostly from inaccurate workload reports. For many years, these data have been validated against federal definitions through the Workload Validation program to minimize losses through overreporting; data from the program are not amenable for use in assessing potential leakages from this source.

SESA Administrative Operations

Within SESAs, the bulk of UI administrative effort is directed toward accomplishing the primary mission of paying benefits and collecting taxes. The remaining effort is spent on the various housekeeping or overhead functions supporting that mission: personnel activities, computer operations, procurement, research and analysis, and evaluation. The major vehicle for examining all of these operations is called Internal Security, which comprises a variety of “risk assessments” of all SESA functions, including those involving its chief mission. As such, Internal Security often overlaps with other assessment or quality assurance activities, including BPC, Revenue Quality Control, investi-
gations or studies spawned by the findings of BQC and various audit efforts. Internal Security assessments often lead to internal investigations and/or audits.

The U.S. Department of Labor recently funded a risk-assessment project. In it, Internal Security experts from fifteen states identified and ranked internal risks of various sources. Principal risks to benefit payment integrity involved centralized check-printing and the possibility for SESA employees to process UI benefit claims for friends and family members. In the tax area, the experts noted numerous weaknesses in current centralized cashiering processes, lack of audit trails, lack of intact deposits in the field, and poor physical security for staff and buildings in the field. In other aspects of agency operations, the report noted numerous risks to computer systems: lack of passwords and identification numbers or infrequent changes to them, lack of backups of key systems and files, ability of dial-up users to change the state UI data bases or to obtain information without identifying themselves and a general lack of computer controls.

In FY 1995, states reported detecting approximately $1 million in UI employee fraud through their internal security operations. Half involved SESA administrative funds, most of this lost through embezzlement. A total of about $150,000 in misappropriated UI benefits was detected, mostly involving improper claims for others. The remainder involved contributions, of which misappropriated refunds was the largest source. In addition, SESA staff estimated undetected losses of $650,000 and that their controls prevented another $1.7 million from being lost.

Trust Fund Operations

The Secretary of the Treasury is trustee for the Unemployment Trust Fund (UTF) established under section 904 of the Social Security Act (SSA). The UTF contains a separate subaccount for each state. These accounts increase with the deposit of UI tax collections from employers and from interest accruals, and they decrease as states withdraw funds to make benefit payments. To avoid having to borrow or to delay benefits in recession years when UI payments are high, states are
encouraged to build up reserve balances in years of low unemployment. Ideally, reserves would be accumulated by drawing contributions from employers when the economy is expanding, and reserves would be drawn down by increasing benefit payments that maintain aggregate spending during recessions. In chapter 9, the macroeconomic stabilizing aspect of ideal UI financing is examined.

Funds going into and out of the UTF pass through operational accounts for each state: the Clearing Account for tax receipts and Benefit Payment Account for payments. The main risk of losses to or leakages from the trust fund, and therefore to the UI system, comes from states that retain balances in operational accounts longer than permitted under applicable federal law (SSA, FUTA, Cash Management Improvement Act [CMIA]). In doing this, states are tempted to use interest accruals for purposes other than paying benefits or refunding employers, proscribed by the so-called "withdrawal standard." Actual diversion of funds is always a theoretical risk but in practice is fairly easy to detect and would occasion an immediate conformity action.

Inflows into the trust fund through the Clearing Account are subject to the "immediate deposit" requirement (FUTA section 3304[a][3] and SSA section 303[a][4]). In practice, the U.S. Department of Labor has interpreted this by establishing a DLA of two days for transfers from the Clearing Account to the trust fund. In FY 1994, thirty-six states met or exceeded this DLA: eight typically made transfers within one day. Data show that fourteen states failed to meet the DLA (Virgin Islands data are unavailable). Their deposits, totaling nearly $7.0 billion, took an average of 5.6 days to be deposited in the UTF. This is almost four days longer than the standard. At the average interest rate the funds would have earned (6.76 percent), this implies losses of $4.6 million to the UTF.8

Until the CMIA of 1990 became effective in 1993, the U.S. Department of Labor monitored a DLA for withdrawals from the Benefit Payment Account, similar to the one for Clearing Account transfers. Since 1993, payment account withdrawals have been managed according to individual draw-down agreements between the states and the U.S. Treasury. These allow many states to retain cash balances amounting to a few days of UI benefit payments in order to defray bank charges. Nevertheless, balances for thirteen states averaged only 0.5 days worth of payments or less: six states had zero balances. Among the fifty-one
states that reported, the median balance was 1.6 days of UI benefit payments, with the maximum being 12 days.

**Some Qualification and Measurement Issues**

The decision environment of the federal-state UI system is ever changing. The general tightness of government budgets has affected the availability of UI administrative funding. States have been forced to reexamine priorities and to seek less expensive means of paying benefits and collecting taxes. At the same time, technology seems to be offering simpler, more convenient, and less costly ways for states to make benefit payments. Following the lead of Colorado, several states have begun to take UI benefit claims over the telephone. Other states have experimented with different alternatives to paying by check. The effect of these changes on program integrity and on the willingness and ability of states to assess risk is unknown. In the short run, tighter budgets are inducing states to emphasize their basic mission at the expense of monitoring integrity. Under the newly proposed comprehensive improvement system called UI Performs, the U.S. Department of Labor has suggested reducing the benefit payment accuracy sample to about half the size used by the BQC program, and allowing states complete flexibility to verify information for sampled units by telephone, mail, and fax instead of in person.

The previous sections of this chapter have reviewed the comprehensive range of efforts taken to identify and correct financial leakages from the UI system. To identify or measure actual or potential losses, states use detection and recovery systems such as BPC and employer field audits, as well as estimation systems such as BQC. Nonetheless, some gaps and measurement issues remain. Four of these principal issues are discussed in the following subsections: (1) the meaning of overpayments as measured by the BQC system, (2) the effect of inaccurately denied claims, (3) the estimation of noncompliance with contribution reporting requirements, and (4) the size of interest losses due to excess state cash balances.
The Meaning of Benefits Quality Control-Estimated Overpayments

The Random Audit BQC methodology estimates proper, under- and overpaid continued weeks claimed by extrapolating from estimates based on samples of individual weeks paid. The samples are drawn so as to provide an accurate cross-sectional picture of payments made in every state in every week. Each payment sampled is painstakingly reconstructed in accordance with written state law and policy. For 1994, BQC estimated that, if all payments had been made correctly, UI outlays would have been $19.58 billion. That is, actual outlays of $21.21 would have been reduced by $1.85 billion of overpayments and increased by $0.19 billion of underpayments.

The $1.85 billion estimate of overpayments produced by the quality control group needs to be qualified. On the one hand, as a measurement vehicle it probably understates overpayments. Over the past three years, BQC was unable to verify half of worksearch contacts; according to BQC procedures, these are counted as proper. Also, as indicated in note 4, the BQC methodology is not as well suited as that of the BPC crossmatch and post audit to detecting concealed or underreported claimant earnings. Conceptually, on the other hand, BQC estimates tend to exaggerate overpayments. Maintaining continuing UI eligibility involves the joint fulfillment of two requirements: remaining unemployed and satisfying various eligibility conditions imposed by state UI law. Although the two conditions coincide closely, the fit is not perfect. BQC estimates the numbers of weeks and dollars that should not have been paid because eligibility conditions were not fulfilled. Many of those claims involving continuing eligibility violations would, however, have been paid eventually for individuals with long unemployment terms.

The BQC methodology estimates overpayments by applying state UI eligibility provisions and the applicable state penalty structure. This approach implies that if claimants, employers, and SESA staff fulfilled all program requirements, overpayments and underpayments would be eliminated and trust fund outlays would be reduced by the difference between the two—which amounted to $1.6 billion in 1994. While this assumption is valid for certain kinds of overpayment mistakes, e.g., monetary and most separation errors, it is not true for some other types. Prime examples are failure to register with the Job Service and
failure to make work search contacts. As an illustration, the typical penalty for neglecting to register with the Job Service for a particular week is loss of benefit eligibility for the week in question. Following state rules, BQC methodology assigns such an improperly paid week as an overpayment. However, this penalty typically does not reduce the total benefits payable on a claim; it simply delays payment. Further, available evidence is clear that relatively few UI claimants become reemployed through the Job Service, so the expected reduction in length of unemployment from one week's registration with the Job Service is much less than one week. The BQC method therefore overestimates the savings to the UI Trust Fund if the spell of unemployment continues beyond the improperly paid week. The case of worksearch violations is a similar example, although not as extreme. Other, analogous situations could be cited.

The Accuracy of Benefit Denials

The UI system does not assess the accuracy of decisions to deny claims with the same intensity as benefit payments are investigated. In part, this is because denials are relatively infrequent: in 1994, only one in ten initial claims was denied for monetary reasons, one in eight monetarily eligible claims was denied for separation reasons, and one in sixty-one continued claims was denied for continuing eligibility reasons. Using data in claims files, each year the Quality Performance Index (QPI) rates adherence to procedures and application of law and policy for separation and continuing nonmonetary eligibility determinations. No field checking is done nor is accuracy per se determined. Claims denied for failing monetary eligibility conditions are not assessed at all. Thus, BQC's estimate of underpayments remains incomplete.

In 1987, the U.S. Department of Labor conducted a five-state pilot test of measuring denied claim accuracy using the BQC methodology. Initial errors in monetary denials averaged 23 percent and in nonmonetary denials about 15 percent before correction through redetermination or appeal. No dollar estimates could be attached to these findings. As part of the redesign of benefit and tax performance measures to be implemented through UI Performs, the accuracy of denial decisions will be assessed. In all probability, this will be done using the BQC
field-verification approach. Pilot testing, due to start in 1997, will precede nationwide implementation.

Estimating Compliance with Contribution Reporting Requirements

As noted, the accuracy of contribution reports could be estimated by a general application of the Illinois model, in which a random sample of firms in each state is drawn and audited. An inference could then be made about overall compliance. Furthermore, noncompliance profiles developed in the process could be used to guide sample selection for future audits. Unfortunately, to achieve what is considered reasonably satisfactory precision, large audit samples would be needed because of the large firm-to-firm variation inherent in audit findings.

Design work by Abt Associates has suggested that stratified random samples of approximately 1,600 subject employers should be drawn in most states. In the Illinois employer compliance pilot conducted in 1988, nearly 900 firms were sampled. Taking these as the range for a nationwide measurement effort, somewhere between 49,000 and 85,000 employers would have to be audited. This is a significant share of the 129,000 audits actually performed in 1994. The benefits and costs of mounting such a measurement effort are still being considered within the U.S. Department of Labor.

The Measurement of Foregone Interest from Unemployment Trust Fund Transfers

In the section on trust fund operations, an estimate of $4.6 million was given as the amount of funds lost by the UTF for fourteen states in 1994 that failed to meet the DLA of allowing at most two days for funds to reside in the clearing account before their transfer into the UTF. As noted, there is no comparable DLA for the maximum number of days payments should be retained in the Benefit Payment Account. A glance at U.S. Department of Labor data shows, however, wide variation across states in both series. Two states are able to transfer funds to the Clearing Account within 0.1 day, and seven states performed this task in 1 day or less, but one state took nearly 49 days. In the case of the Benefit Payment Account, six states held zero balances and the median was 1.6 days, but eight states exceeded 4.5 days with the high-
est being 12.1 days. Current banking technology permits both swifter transfer into the trust fund and much smaller balances in the Benefit Payment Account. In light of present technology—as shown by performance in many states—foregone interest would seem to be much greater than the estimate presented.

Summary and Conclusions

The estimates reported in this chapter suggest that losses to the UI system during CY 1994 were approximately $3 billion. This total amounted to about 7 percent of total system financial flows in 1994. Leakages from benefits were $1.9 billion, over 8 percent of benefit outlays. Leakages from the tax stream were composed primarily of estimated underreported contributions ($935 million) and known but uncollected contributions ($258 million). These leakages totaled approximately $1.2 billion, or 5 percent of state tax collections. For reasons outlined earlier in the chapter, estimates of leakages from both streams are probably somewhat low.

Despite some underestimates and missing data, the figures for UI system financial leakages given in this chapter seem to be in the right ballpark. The two largest missing components are underreported FUTA taxes and underreported state and FUTA taxes by “hidden” employers. A total of some $5.5 billion in FUTA taxes was actually paid in 1994. The fixed taxable wage base and tax rate for FUTA suggest that the rate of underreporting might be lower than for state UI taxes. If FUTA underreporting is of the same magnitude as state contributions, losses to the federal Treasury (not UI trust funds) could be on the order of $200 million. Hazarding a guess at how large the “hidden employer” problem might be is difficult, but for several reasons it might be assumed to be rather small. States routinely use many devices to identify subject employers—various checks with taxing and licensing agencies, reviewing classified ads, and the like. Blocked claims investigations turn up others as former employees claim benefits only to find their wages not on file with the UI agency. No estimates of these or of two other sources—misreporting due to improperly set state tax rates,
or overpayments in administrative allocations due to overstated work-
load data—have been attempted. Both can be expected to be small.

The UI system’s partners tend to have different degrees of concern
about leakages, with the federal partner, particularly the U.S. Depart-
ment of Labor, tending to have a higher level. It is vested with over-
sight responsibilities, more detached from operational involvement,
and more subject to concerns about fraud and abuse in the national
political arena. It has thus tended to push or induce states to put more
effort into performance measurement and other forms of integrity
activities than they would generally select on their own.

Each state sees its response as involving a weighing of responsibili-
ties, benefits, and costs. The first balance the state must strike is
between operating the basic program and attempting to ensure its
integrity. The typical SESA sees its primary duty as serving its custom-
ers by paying benefits and collecting taxes. The numerous opportuni-
ties and incentives for leakages created by the interaction of complex
UI laws and policies and sparse administrative funding levels were
noted earlier.

In this environment, integrity must be pursued by balancing various
activities. The first involves integrity or performance measurement.
The UI agency must have reliable assessments of the extent of under-
collected or underpaid taxes and of over- and underpaid benefits to
know how serious are its losses, where they occur, and why. Under-
standing the seriousness of its problem allows it to decide on the rela-
tive balance between operations and integrity activities. It must then
assess how much energy to devote to further measurement and balance
initiatives to change its legal framework, improve operational pro-
cesses within a given legal framework, conduct activities designed to
detect and deter leakages, and recover outstanding balances. At all lev-
els, the U.S. Department of Labor has tried to increase states integrity
efforts.

In the short run, UI agencies can often do little to change “the sys-
tem”—the complex rules affecting benefit eligibility and tax liability—
within which they work. For a number of historical reasons, most state
UI systems have accrued a variety of subtle distinctions defining equi-
table treatment. Students of UI integrity, chief among them Kingston
and Burgess, have pointed out that program complexity is quite costly,
especially in terms of administrative effort, inequities among similarly
situated claimants and employers, and incentives for fraud. They have urged states to consider simplifying their UI programs where possible.\textsuperscript{11}

Despite the difficulties of altering the system, the results of performance measurements have led to changes in this environment. Both the Random Audit and BQC programs identified worksearch violations as a prime cause of benefit overpayments. (In the early years of Random Audit, worksearch issues accounted for an about half of measured overpayments.) In response, many states changed their worksearch requirements, generally to make them more liberal or to require claimants to receive a formal warning before a worksearch disqualification could be assessed. In 1994, work search accounted for only 17 percent of national average dollars overpaid, and the decline in work search overpayments represented most of the decrease in average overpayments. Changes in law accounted for much of the reduction in errors due to work search.

Changes in worksearch laws and policies have reduced worksearch-related errors, but the basic structure of incentives and disincentives making noncompliance attractive for many claimants and employers remains. BQC attributed half of its 1994 estimated overpayments solely to intentional or accidental claimant actions. This amounts to over $900 million. Adding in joint responsibilities with the UI agency or employers raises the figure to $1.2 billion. Employers are responsible for underreported taxes ($935 million). In addition, over $250 million of unpaid taxes could not be collected in 1994. Even though these losses largely reflect behavior UI agencies cannot affect directly, their size challenges the states and the U.S. Department of Labor to continue to address their causes.

Within a given system, states must next decide how much effort is warranted to prevent leakages by improving the efficiency of various processes. These decisions are generally guided by estimates of the size and causes of leakages and should be shaped by considerations of cost versus probable effectiveness. Performance measurements have played a noticeable role in process change. A salient example comes from Random Audit experience. Random Audit findings showed convincingly that states using computerized wage records made more accurate monetary determinations than those who requested monetary data from employers at the time of initial claims. Partly as a result, the
number of wage-request states has gone from about a dozen in the early 1980s to two at present. Under the Quality Control program, states have conducted nearly 150 program improvement studies, funded either with grants or supported with BQC staff temporarily released from verification duties. They have implemented over 40 of the recommended improvements.

State efforts notwithstanding, BQC data suggest a slowing pace of improvement in accuracy. When states were first implementing Random Audit in the early 1980s, the national average overpayment rate was on the order of 12 to 15 percent. The first BQC report was for CY 1988; overpayments averaged 10.1 percent for the country. They have since fallen to about 8.6 percent, as of 1994. If Michigan is excluded, however, the decline is from 9 percent in 1988-1989 to 8.1 percent in 1990-1994. The drop in overpayments due to worksearch violations has accounted for the entire decrease in BQC overpayments between 1988-1989 and 1992-1994, as it seems to have for the decline in Random Audit days as well.

Still, BQC data suggest a fertile area for further improvements in accuracy does lie within the agencies’ direct control. Of the $1.82 billion overpayments estimated for 1994, SESAs were totally responsible for over $400 million. They shared accountability with others, mostly claimants, for another $290 million. The extent to which these “costs of complexity” can be reduced by process improvements is a direct challenge for the future. Many errors involve failure to register claimants with the Job Service. Even perfect registration of claimants would have only limited value in shortening unemployment durations for claimants.

Again using the calculus of costs versus expected benefits, states must decide how much effort should go into detecting and recovering overpaid benefits and underpaid taxes. As with many performance measurement systems, U.S. Department of Labor assistance, requirements, and funding have exerted an important influence on this integrity activity. Although such efforts “clean up” after leakages occur, making the system aware of them and their effectiveness is also intended to deter claimants and employers from committing fraudulent actions in the future. In 1994, BPC activities detected some $540 million in actual overpayments, about 30 percent of what BQC estimated in total. Of this, some $260 million was recovered. Field audits are the
main tax equivalent to BPC activities. In 1994, field staff audited about 130,000 subject employers and identified and recovered $53 million in underreported contributions. This is about 6 percent of our rough estimate of the total. Recent experience shows the effect of federal targets on this process. In 1990, with a DLA to audit 4 percent of subject employers (versus the 1994 DLA of 2 percent, reduced to phase in more stringent auditing standards), states conducted 177,000 audits and detected $84 million of underreported contributions.

As noted, most estimated overpayments and underreported taxes involve evasive behavior by claimants and employers. Massive efforts to restructure the UI system’s incentives are unlikely. Narrowly defined process improvements, at least to improve benefit payment administration, have had, overall, slight effects on payment accuracy. The most productive avenue remaining might thus be more, and more intelligent, detection and recovery efforts. Students of UI integrity have concluded that much evasive behavior is systematic, and thus liable to detection and deterrence by computerized profiling. They have urged this for increasing employer compliance with tax reporting laws and for screening claimants to focus scrutiny on those persons statistically more likely than average to violate various UI eligibility provisions (Blakemore et al. 1996; Burgess 1992; Burgess and Kingston 1987, p. 256). Such work could build on the profiling systems developed to identify laid-off individuals who are prone to need extensive reemployment assistance and implemented in the past two years. Benefits profiling could use the extensive BQC records. Employer profiling would require each state to mount one-time, if not continuing, random audit programs of employers as was done in Illinois. The targeted selections of workers would help SESAs focus enforcement efforts, information, and job search assistance on workers most likely to need them. Targeted employer audits would increase yield. Both should also provide more effective deterrence if the activity and results are publicized (Kingston, Burgess, and St. Louis 1986, p. 334; Blakemore et al. 1996, p. 22).

In the fall of 1995, a joint state-U.S. Department of Labor work group proposed a new approach to performance management called UI Performs. It is intended to address all dimensions of quality and to improve the system’s balance between measuring performance and taking actions to raise it. UI Performs is built around more federal-state
cooperation, an explicit commitment to continuous improvement, and stronger joint performance planning. When fully implemented in 1998, it should provide the system with improved performance measures, including an indicator of the accuracy of decisions to deny benefits. It also incorporates initiatives nearing completion to improve benefits timeliness, quality measures, and tax performance. The incentive to analyze experience and make program improvements will be strengthened by a more comprehensive planning process. By inducing the U.S. Department of Labor and states to look more broadly and in a balanced way at total performance, UI Performs has the potential to help stanch leakages at all levels, possibly through such innovative approaches as greater targeting of compliance efforts.

**NOTES**

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1. For a concise, thorough statement of the incentives and disincentives for compliance with benefit eligibility provisions, see Burgess (1992). A more complete treatment is Burgess and Kingston (1987), especially chapter 6. A review of incentives for employers to comply with contribution reporting requirements is given in Blakemore et al. (1996).

2. In 1996, the BQC was renamed the Benefit Accuracy Measurement (BAM) program.


4. Conceptually, the BPC wage record crossmatch is a more thorough mechanism for detecting benefit-year earnings than BQC. BQC identifies earnings directly through the claimant interview (and so depends on claimant honesty) and indirectly through various employer verifications. The BPC crossmatch obtains positive matches on all work reflected in wage record data. In practice, however, crossmatch programs screen out instances where abuse is likely to involve small dollar amounts; additionally, agency staff cannot afford to investigate many other low-potential “hits.” The 1979 pilot that developed Random Audit included a crossmatch and postaudit. Based on one quarter’s crossmatch, these raised detected overpayments by 0 to 20 percent (average: 7 percent). Because of the small average effect, and the large delay it occasioned in case completions, this feature was not included in either Random Audit or BQC.


6. See Blakemore et al. (1996). The authors note that the Illinois study could not help but underestimate the rate of underreporting. Illinois could not audit firms headquartered out of state, and this knowledge may have affected their compliance. Of course, the study also included only registered employers, so noncompliance by “hidden” employers could not be estimated.

7. The actual FUTA tax rate is 6.2 percent. Employers pay 0.8 percent if they remit the correct amount of state taxes in a timely manner and the state is eligible for the offset credit of 5.4 percent.

8. The U.S. Department of Labor is now investigating an additional avenue by which interest may be lost by the UTF. In some states, additional accounts may be maintained by non/UI agencies that collect UI taxes. These accounts can be the repository of UI funds before they are trans-
ferred to the standard clearing account. Such accounts can therefore both delay the deposit of monies into the fund and affect how accurately the timeliness of transfer from the Clearing Account can be measured.

9. This general issue was first raised by Burgess, Kingston, and St. Louis (1982, pp. 37-39) in the context of how much tighter UI administration might reduce trust fund outlays.

10. See Marcus and Battaglia (1990) and subsequent analyses.


12. Michigan data, although questionable, were published in 1988, publication was suspended in 1989-1992 and only resumed in 1993 when the state achieved adequate BQC quality. The bulk of Michigan overpayments involve “other eligibility” failures, mostly failure to register claimants with the Job Service.
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