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Preparing for Recession in the States: Strengthen the Unemployment Insurance System

By National Employment Law Project

With the recession taking hold and unemployment claims rising, the states are feeling the blow in the form of increased demand for state services, declining revenues, and tighter state budgets. This combination of forces requires state policy makers to make hard choices to maintain safety net programs and support the local economy. What follows is a brief outline of the key role that Unemployment Insurance (UI) can play to help address these concerns as the recession starts taking its toll in the states.

While Congress and the President debate whether to provide much-needed UI assistance as part of the economic stimulus package, the states -- as they begin their legislative sessions -- are also in position to move forward with UI reforms to help fight off the recession. California, the District of Columbia and Virginia, have already taken steps in the past month to strengthen their UI programs in anticipation of the recession. If other states follow their lead (building on the federal UI measures, if they are enacted) they too will be making significant progress toward alleviating the individual and community hardships of the economic slowdown.

The Basic Framework of the UI System

- The federal-state UI system provides state UI benefits to involuntarily unemployed workers. Regular state UI benefits last 26 weeks (in all but two states). They are financed through state payroll taxes and paid from state trust fund accounts maintained in the U.S. Treasury.

- Separate federal UI trust funds are supported by a federal UI payroll tax and pay for the entire cost of state and federal UI administration and one-half of Extended Benefits (EB). EB is triggered on by high unemployment in a state and pays up to 13 weeks (20 in certain circumstances) of additional benefits to those exhausting regular UI benefits.

- Currently, state trust funds total more than $50 billion overall, and federal trust funds exceed $38 billion. Both state and federal UI trust funds are legally dedicated solely to the payment of UI benefits and program administration.

- Current federal payroll taxes under the Federal Unemployment Tax Act (FUTA) are imposed only on the first $7,000 of wages at an effective tax rate of eight-tenths (0.8) percent, or $56 per covered employee. The current FUTA taxable wage base of $7,000 was set in 1983, and its failure to keep pace with inflation has resulted in FUTA taxes falling to their present historic low levels.

Investments in UI Benefits Boost the State Economies

- The UI system is often referred to as the “first line of defense” in the event of a recession, not just because it is relied upon to provide income support when needed to laid off workers but also because the money invested in UI benefits during recessions significantly boosts and stabilizes the economy.

Low-wage workers in particular spend a significant amount of their UI benefits in their communities on necessities and other basic goods and services.[1]

- A recent study commissioned by the U.S. Department of Labor concluded that over the last five recessions, UI has "mitigated the loss in real GDP by about 15% over all the quarters in the recession" and that the "average peak number of jobs saved was 131,000." The study also concluded that each $1 of unemployment insurance benefits boosts the nation's GDP by $2.15. The greater number of workers who end up collecting UI and the more they collect in benefits, the greater the impact that the UI program will have in supporting a state's economy.[2]

Most State UI Funds are Equipped to Handle the Recession

- Despite the rise in layoffs and the risk of recession, most state UI trust funds have built up sufficient reserves over the past decade to be able to handle a mild or moderate recession. 35 states have enough reserves in their UI accounts to pay benefits at peak recessionary levels for about one year without taking in any additional UI revenue.

- A leading expert in UI financing, Wayne Vroman of the Urban Institute, has observed: "This won't be a repeat of 1982-83 recession" when many states ended up cutting benefits, raising taxes and borrowing from the federal government to pay benefits. The current levels of funding in the state trust funds is nearly triple the amount paid out in UI benefits last year.[3]

- Many states recently cut UI taxes dramatically rather than build up their UI reserves during the recent economic expansion. As reported in a recent NELP study, UI payroll taxes on employers reached their lowest levels in the 65-year history of the program, now averaging five-tenths (0.5) percent of their total payrolls.[4]

- As a result, some of these states will have serious difficultly paying UI benefits in the coming months. Half a dozen states, including Texas, North Dakota, New York, Illinois, West Virginia, and Missouri, are on our "watch list" because their trust funds cannot afford to pay UI benefits at peak recessionary levels for more than six months without taking in any additional revenues.

States UI Programs Fail to Adequately Support the Unemployed

- A number of states with ample UI trust funds have accumulated those balances while operating limited UI programs that pay below average benefits to an especially small proportion of their unemployed workers. As a result, absent reforms to strengthen their UI programs, these states will provide minimal protection to their laid off workers and reap the least benefit from the economic boost provided by the UI system.

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[1] According to a survey conducted as part of the 1995 report of the Advisory Council on Unemployment Compensation, households with incomes between $5,000 and $9,999 spent between 84% and 113% of income on necessities including food, clothing, medical care, housing and transportation. 1995 ACUC Report, at p. 132.

[2] Lawrence Chimerine, et al., *Unemployment Insurance as an Economic Stabilizer: Evidence of Effectiveness Over Three Decades* (1999).

[3] "Texas, New York Might Need to Borrow to Bolster Jobless-Compensation Reserves," *Wall Street Journal* (October 15, 2001).

[4] Marc Baldwin, *Beyond Boom and Bust: Financing Unemployment Insurance in a Changing Economy* (National Employment Law Project, 2001).

- Low-wage, part-time and women workers are often denied unemployment benefits due to state eligibility rules, thus creating a special hardship on those families (many of them recently employed after coming off of welfare) who are especially in need of the income support provided by the UI system.

- Among the more solvent states paying lower than average weekly UI benefits are Alaska, Arizona, Georgia, Louisiana, and Mississippi (the District of Columbia, California and Virginia were also on the list until they recently indicated they were raising their benefits, as described below). Other states with lower than recommended weekly UI benefit amounts are Alabama, South Dakota, Tennessee, Montana, Missouri, and South Carolina.

- States with restrictive UI program eligibility and above-average trust fund reserves include Arizona, Colorado, Florida, Georgia, Louisiana, Mississippi, New Hampshire, New Mexico, Oklahoma, and Virginia. Colorado, Maryland, South Dakota, Nebraska, and Wyoming. These states and others pay UI to less than 30% of the state's unemployed, well below the national average of just 39%.

A State Agenda to Strengthen UI & Prepare for the Recession

State legislators and governors should consider the following measures that will improve the UI safety net, enhancing the economic security of laid off workers and providing economic stimulus to fight state recessions.

1. Expand Eligibility to Capture More Low-Wage & Part-Time Workers

Because of outdated eligibility rules, most unemployed workers – over 60% in 2000 -- don't collect UI. The restrictive state laws create an ever more severe problem for low-wage, part-time and women workers. Many of these workers are supporting families who were previously collecting time-limited welfare (TANF) and who are now finding themselves laid off and less able to access the welfare system.

- Adopt the Alternative Base Period. The "alternative base period" (ABP) is the most significant reform available in most states to expand eligibility for low-wage workers, new entrants to labor market (including welfare recipients), and re-entrants to the workforce. [5] It requires states to use the worker's more recent wages to measure UI monetary eligibility (most states don't otherwise count the individual's most recent 3-6 months of wages needed to qualify for UI). Twelve states (Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Rhode Island, Vermont, Washington, and Wisconsin), representing about one-third of the nation's UI claims, have already done so.[6]

- Level the Playing Field for Part-time Workers. Nearly one-fifth of workers are part-time, but in most states part-time workers cannot collect UI because states require UI claimants to be able to accept full-

[5] National Employment Law Project, "What is an 'Alternative Base Period & Why Does My State Need One?" (March 2000).
[6] A recent New Jersey study found that over half of the unemployed workers who most recently left welfare were able to qualify for UI without delay as a result of the ABP. In contrast, 34% of former welfare recipients collected UI using the standard base period which does not count the individual's more recent earnings. Anu Rangarajan, Walter Corson, Robert Wood, *Is the Unemployment Insurance System a Safety Net for Welfare Recipients Who Exit Welfare for Work?* (Mathematica Policy Research, Inc. June 2001), pp. 17-18.

time work, even if they meet UI state monetary eligibility requirements through part-time work.[7] These workers are predominantly women and disproportionately low-income. States should eliminate the restrictions on an individual's part-time work search where it's clear that part-time job opportunities exist.[8]

- Recognize Compelling Domestic Circumstances for Leaving Work. Most states don't permit "personal" reasons to qualify as "good cause" for leaving work, thus denying UI to many women workers in particular. Several states, however, cover "compelling domestic circumstances" as valid reasons for leaving work and collecting UI. These and other more targeted "good cause" provisions protect workers forced to quit work to care for sick children, partners or parents; leaving work due to child care/shift work conflicts; or quitting due to domestic violence. Significantly, these benefits are not "charged" to the employers, meaning that the employer's UI tax rate is not increased when the worker collects UI. When good jobs are even harder to find due to the recession, working families should not be denied UI simply because they are forced to leave work to accommodate urgent family needs.

- Offer Interim TANF-Funded Support. While advocating that UI should be available for all workers who have contributed to the labor market, some policy makers have also developed proposals to provide interim TANF assistance to those families who don't qualify for UI. The problems of TANF families are now especially acute as a result of the 5-year time limit on cash assistance, which is scheduled to take effect in all states this year. However, under the TANF regulations, a benefit of up to four months can be funded with the TANF block grant as "non-assistance", that is as a grant not subject to the 5-year time limit.[9] Advocates have proposed adopting these provisions to provide interim cash assistance to TANF families who don't qualify for UI, either because they don't meet the earnings requirements, they have left work for reasons not covered under the state laws, or their unemployment claims are on appeal.

2. Boost the Value of UI Benefits & Extend the Weeks of Support

Too many states pay inadequate weekly UI benefit amounts, thus undermining the program's ability to support working families and to invest new resources to help stabilize the economy. What's needed is benefits expansions of the sort recently adopted in some states. For example, Virginia and the District of Columbia (D.C.) recently increased their benefits in response to the recession. The D.C. provision increases the replacement value of the UI benefits from 50% to 75% of the individual's previous wages, lasting temporarily for claims filed from September 9, 2001 through March 9, 2002.[10]

- Increase the Average Weekly UI Benefit. As described above, states should increase their UI benefit levels by replacing a higher percentage of the worker's previous wage and indexing benefits to the state's average weekly wage. Currently, state UI benefits average just $231 a week, replacing only 33% of the average weekly wage in the states. The average weekly benefit ranges from $314 a week in Massachusetts to $161 in Mississippi. In the midst of the decline in

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[7] National Employment Law Project, "State Unemployment Insurance (UI) Policies Related to Workers Seeking Part-Time Employment While Collecting UI" (August 2001)
[8] National Employment Law Project, "Part-Time Workers and Unemployment Insurance" (Revised March 2001).
[9] 45 C.F.R. Section 260.31(b)(1).
[10] A recent study documented how the last federal extension of UI benefits, the Emergency Unemployment Compensation (EUC) program, unevenly benefited the states due to the variation in state benefit amounts. For example, the EUC program added as much as $1,359 per unemployed worker to the economy of Massachusetts and only $327 per unemployed worker in Louisiana. *Unemployment Insurance as an Economic Stabilizer*, at page 40.

the economy, several states have recently raised their benefits. For example, California, which previously had the lowest average benefits in the U.S., increased its maximum benefits by $220 over five years (phasing in starting January 2002) and required UI benefits to replace 50% of the individual's weekly wage (up from 39%). In response to the recession, Virginia's Governor announced an increase in the state's maximum benefits from $268 to $368, and the D.C. Council enacted the temporary increase described above.

- Eliminate or Suspend the "Waiting Week". Most states -- all but 12 -- require workers who qualify for UI to serve a one-week waiting period before collecting their first UI check, thus eliminating one week of benefits for everyone except those who end up exhausting their 26 weeks of state benefits. Some states have entirely eliminated the waiting week, while others reimburse workers for the one week if they collect UI for longer than several weeks. The Governors of California, New Jersey, New York and Virginia recently suspended their waiting weeks by Executive Order in specific response to the September 11th attacks and the devastating impact the events have had on the economy. In addition to increasing its benefits temporarily, the D.C. Council also enacted legislation waiving the waiting week.

- Reduce Offsets Against UI Benefits. Many states offset UI benefits against various other sources of income, including severance pay, pensions and Social Security benefits. To maximize the income available to laid off workers, and assist the increasing number of workers who urged to accept layoff packages in a declining economy, all states should revisit theses policies and reduce or eliminate selected offsets that deny UI benefits to laid off workers.

- Enact UI Extensions. Over the past year, 2.4 million unemployed workers exhausted their regular 26 weeks of UI, which accounts for one-third of all workers who collected an unemployment check. During hard economic times, unemployed workers often incorrectly assume that additional UI benefits will be available to them beyond their 26 weeks of regular UI. In fact, the permanent federal-state program intended to provide 13 weeks of additional benefits -- the Extended Benefits (EB) program -- failed to operate in all but a handful of states during the last recession due to a faulty formula used to trigger benefits in each state. As a result, Congress ended up enacting a federally-funded extension several months into the last recession. Several states have taken steps to anticipate these limitations in federal policy. Some states routinely provide more than 26 weeks of UI, even during good economic times. Seven states have adopted an alternative EB trigger formula that operates more effectively than the standard EB formula. Some states have also funded their own extensions. For example, Indiana provides up to 13 weeks of additional UI for those who are collecting benefits as a result of declared disaster.

- Extended Benefits for Workers in Training. During hard economic times, workers are often best advised to seek retraining. However, most workers can't afford to participate in training while they are unemployed unless they are also provided with income support. Under federal law, workers cannot be denied UI while participating in state-approved training programs. In addition, several states have enacted programs allowing unemployed workers to collect supplemental UI benefits while in training. Washington recently enacted a model program, providing up to 52 weeks of UI (Washington's standard UI program provides up to 30 weeks of benefits) to a broad category of displaced workers participating in skills training. In addition, Washington provides up to 74 weeks of UI to selected categories of workers displaced from jobs in the aerospace, timber and fishing industries.

3. Additional Measures of Special Significance During Recessions

- Prevent Abuse of Work Search Requirements. All states require workers to be looking for work while collecting UI and to be willing to accept suitable work. Although often under enforced, federal UI law also imposes special protections related to the kinds of jobs that workers can be made to accept by the state to continue receiving UI. When jobs are scarce and UI state funds are more stressed, there may be more pressure in some states for workers to be forced to accept substandard jobs (e.g., temp work or lower paying jobs) as a result of the suitable-work requirement. State policy makers should protect against stricter enforcement of the suitable work requirement and enact clarifying legislation where necessary. More generous work search policies can also be adopted, such as waiving the work search rules when the unemployment rate exceeds significant levels within a state (this provision exists in at least one state, Michigan).

- Explore Work-Sharing (or Short-Time Compensation) Programs. A number of states (Arizona, Arkansas, California, Connecticut, Florida, Iowa, Kansas, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, New York, Oregon, Rhode Island, Texas, Vermont and Washington) operate special UI programs that allow employers faced with the need to layoff workers to instead reduce the hours of the workforce and provide UI benefits to help fill the gap in the missing wages of the workers. These programs differ among the states, but they generally require the employer (and the union, where one exists) to petition the state to operate the program. In some states, including California and New York, the duration of UI benefits is limited to less than the normal 26 weeks. In addition, while collecting short-time compensation, workers generally need to work four days a week in order to avoid significant wage losses.

- Improve Partial Unemployment Benefit Programs. All state laws permit workers facing reduced hours of work to draw “partial” or “underemployment” UI benefits while continuing to work part-time. In general, a worker must earn less than his or her weekly UI benefit in a week of less than full-time work to collect partial UI benefits. A major problem with these programs is that the UI benefits are substantially offset against the individual’s wages. To address this inequity, states should enact substantial earnings disregards that apply to partial UI benefits. The income disregards now range from the entire weekly benefit amount in Puerto Rico and one-half the weekly benefit amount in Idaho, Illinois and Nebraska, down to one-fifth of the weekly benefit amount in New Hampshire, New Mexico, Ohio and Rhode Island. The D.C. Council recently increased its earnings disregard by $20 as part of its package of temporary UI reforms.

- Protect Downsized Workers. Many states reduce or deny unemployment benefits when workers accept early retirements or lump-sum incentive packages during mass layoffs or workplace closings. For example, before mass layoffs many employers offer workers lump-sum packages in exchange for leaving work and signing a release/waiver. If enough workers in the group do not accept the incentives, involuntary layoffs without the lump-sum payments follow. Several states hold that these separations are "voluntary" on the part of the workers accepting the lump sums, while others offset UI benefits against the lump sum, effectively denying UI benefits. Given the overall circumstances, these separations are hardly "voluntary" and should not be disqualifying. And, because these lump sum payments represent a cash incentive to liquidate employees' fringe benefits and severance pay, and are conditioned upon a release of other potential legal claims, they should not be considered wage replacements that properly offset UI benefits. In addition, state laws prohibit the waiver of UI benefits, so the "agreements" signed by employees should not be treated as giving up rights to UI. State laws should preserve the income of laid off workers, rather than penalizing these workers by imposing disqualifications and offsets in these situations.

- Protect Workers Who Accept "Inverse Seniority Layoffs." Union collective bargaining agreements sometimes permit more senior employees to elect to accept a temporary layoff, permitting less senior employees to remain at work. This is termed an inverse seniority layoff, because under typical seniority rules those with higher seniority remain at work, while lower seniority employees lose work. (When permanent layoffs occur, then ordinary seniority prevails--that is, the less senior employees are laid off.) The rationale for these provisions is to permit less senior employees to accrue seniority and collect wages (and savings) before a permanent layoff, with more senior employees electing to take time off to spend with family or projects. In effect, these contract provisions give more senior employees an element of choice about whether to work or take time off in a temporary layoff. Some states mistakenly impose voluntary leaving disqualifications on these situations, while others expressly do not. The element of employee choice should not obscure the fact that the employer still determines that a layoff is going to occur and the total number of employees involved. The fact that some employee input occurs as to which specific employees are laid off should not trigger a disqualification, as these separations are essentially economic layoffs.

For more information, please see **Model UI Legislation Appendix** at http://www.nelp.org/pub103.pdf