

Protecting Our Unemployment Insurance Lifeline: A Toolkit for Advocates

National Employment Law Project



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INTRODUCTION

A Message from Christine L. Owens, Executive Director

A key strength of the National Employment Law Project's work is our partnership with labor organizations, community groups, worker centers, and legal aid advocates. In the arena of unemployment insurance (UI), NELP benefits tremendously from its ability to know what is happening around the country through our network of partners in nearly every state. Those friends seek our assistance and input on UI legislation and administrative battles, and, in turn, we seek their help with critical UI fights in Washington, D.C., and in state capitals.

In the spirit of this partnership, and in preparation for state legislative battles in 2012, NELP has prepared this publication, *Protecting Our Unemployment Insurance Lifeline: A Toolkit for Advocates*. The *Lifeline Toolkit* is a follow-up to our booklet-length 2004 publication *Changing Workforce/Changing Economy: State Unemployment Insurance Reform Models for the 21st Century*. This comprehensive publication (updated in 2006) still offers researchers and advocates ideas for UI reform that remain relevant in many states in 2012.

The *Lifeline Toolkit* is designed as a ready reference for our partners for the defensive battles that we anticipate facing together in 2012. Our emphasis is on legislative developments we've seen arise in 2011, some of which will undoubtedly serve as bad examples for other states in 2012. The short pieces here are designed to offer advocates talking points on these legislative topics as well as insights into the arguments offered by those seeking to undermine our UI lifeline through restrictive measures.

About the Authors

Protecting Our Unemployment Insurance Lifeline was produced by NELP's UI team, with Rebecca Dixon, Rick McHugh and Mike Evangelist undertaking the lion's share of research, writing and editing; and team leader George Wentworth and Policy Co-Director Maurice Emsellem adding editorial direction and advice.

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Chapter 1

Benefit Basics

Why States Should Provide 26 Weeks of Unemployment Insurance

Question: Are states required by federal law to provide 26 weeks of state unemployment insurance (UI) benefits?

Answer: No. There is, however, a long-standing practice of paying 26 weeks of benefits in the United States. Since the 1960s and up until 2011, all 53 UI jurisdictions, with the exception of Puerto Rico, paid up to 26 weeks of state benefits. (Two states, Massachusetts and Montana, pay 30 and 28 weeks respectively.) Although there is no federal law designating the maximum weekly duration of benefits, in 1962, the U.S. Department of Labor recommended that states provide a least 26 weeks of benefits if using a uniform-duration formula, or 30 weeks of benefits if using a variable-duration formula.

Uniform duration means that every worker who is monetarily eligible for benefits qualifies for a full 26 weeks of benefits. Currently, only eight states have uniform duration of benefits. The remaining states use a variable-duration formula that caps the total benefit amount based on a share of the worker's base period wages, most commonly one-third of the base period wages. The duration period is calculated by dividing this total benefit amount by the weekly benefit amount. In many cases, this results in claimants receiving less than 26 weeks of benefits, even if they are unemployed for longer periods of time.

Two federal advisory bodies have accepted 26 weeks of state benefits as a standard duration for benefit payments. The Advisory Council on Unemployment Compensation, appointed jointly by Presidents George H.W. Bush and Bill Clinton, made this recommendation in 1995. Additionally, the congressionally mandated National Commission of Unemployment Compensation, which performed the first-ever comprehensive analysis of the UI program, echoed this recommendation. The commission's final report, issued in 1980, recommended that state programs provide a minimum of 26 weeks of benefits during a benefit year.

Question: How many states offer 26 weeks?

Answer: During the 2011 legislative session, six states voted to reduce the maximum number of benefit weeks available to laid-off workers. Effective immediately, Arkansas changed its maximum duration to 25 weeks, while South Carolina and Missouri changed their durations to 20 weeks. Beginning in January 2012, the maximum duration in Illinois will be 25 weeks, whereas Michigan's duration will drop to 20 weeks. Also effective January 2012, Florida has implemented a sliding scale where benefit duration can range from 12 to 23 weeks depending on the state's unemployment rate.

The remaining states still pay a maximum of 26 weeks of benefits, or more in the case of Massachusetts and Montana, referenced above.

Question: What reasons are given for providing less than 26 weeks of benefits?

Answer: There are two main arguments against providing 26 weeks of benefits. First, states may restrict benefits as a way of reducing the cost of their UI programs. With regards to reducing costs, some believe that cutting state benefit weeks simply shifts the costs of those weeks onto the federal government, as the worker will access federal emergency unemployment compensation (EUC) and extended benefits (EB) sooner. However, reducing the number of state weeks also results in a proportionate reduction in the maximum number of weeks of EUC and EB a worker may collect. For example, in Missouri, where state benefits were reduced to 20 weeks, a worker may lose out on nearly 16 weeks of EUC and EB on top of the six-week reduction in state benefits. Additionally, states should not make permanent cuts to the number of weeks available in their state programs in reliance on the federal EUC and EB programs because those programs will eventually expire.

Secondly, proponents of reducing benefits claim that collecting UI benefits is a disincentive to returning to work. Nationally, the average UI benefit replaces only about one-third of the average worker's weekly wage. The financial strain of trying to make ends meet on such a small fraction of prior earnings should provide adequate pressure for most workers to diligently search for work. In fact, a study using a nationally representative sample of unemployed workers found that compared to non-recipients, workers who receive UI benefits search for work more proactively and are more likely to examine job postings, network, and go on job interviews.

Question: What are the arguments for having at least 26 weeks of regular benefits?

Answer: For families and the economy, now is one of the worst times to cut benefits weeks in the states. As the unemployment rate has risen, so has the percentage of workers exhausting their state benefits. In 2007, before the recession began, the unemployment rate was five percent, and 35.2 percent workers exhausted their state benefits. In 2010, the unemployment rate stayed above nine percent the entire year, and exhaustion rates rose to 54.9 percent.

Since the recession began, the unemployment spell of the average worker continues to increase, swelling the ranks of the long-term unemployed to record levels. Although the average duration of state benefits is 20 weeks, it is taking the average worker nearly 40 weeks to find a new job. Of the 13 million unemployed workers, more than 40 percent are long-term unemployed and have been looking for work for more than six months. There is little evidence that cutting benefit durations will result in workers finding jobs sooner; it is self-evident that forcing workers off benefits before they find work creates human suffering and forces affected individuals to seek help from other social welfare programs and charities.

Sources:

Advisory Council on Unemployment Compensation, *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (February 1995): 20.

Carl E. Van Horn and Cliff Zukin, "The Long-Term Unemployed and Unemployment Insurance: Evidence from a Panel Study of Workers Who Lost a Job During the Great Recession" (John J. Heldrich Center for Workforce Development, 2011): 13.

Katelin P. Isaacs, "Unemployment Insurance: Consequences of Changes in State Unemployment Compensation Laws" (Congressional Research Service, 2011).

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Walter Corson and Mark Dynarski, "A Study of Unemployment Insurance Recipients and Exhaustees: Findings from a National Survey" (U.S. Department of Labor Employment and Training Administration, Unemployment Insurance Occasional Paper 90-3, 1990).

Unemployment Insurance Waiting Weeks

Question: What is a “waiting week” in state unemployment insurance (UI) laws?

Answer: The "waiting week" or "waiting period" is a common feature of UI laws. A waiting week occurs during the first week of a spell of unemployment when a jobless worker satisfies all the requirements for eligibility but does not receive benefit payment. As a result, unemployed workers that exhaust UI benefits draw their last payment (typically the 26th and final payment) in their 27th week of unemployment. Claimants who do not exhaust benefits (which vary in duration but usually last 26 weeks) are effectively denied one week of benefits in states with waiting weeks. This reduces benefit payment costs.

In 2010, 45 percent of benefit recipients found work prior to exhausting benefits, so in states that have a waiting week, this is tantamount to reducing these individuals' UI benefits by one week. The average duration of a UI claim in 2010 was 18.9 weeks, as most jobless workers find work prior to exhausting benefits, even in a terrible labor market.

Question: How many states have waiting weeks?

Answer: Twelve states (Connecticut, Delaware, Georgia, Iowa, Kentucky, Maryland, Michigan, Nevada, New Jersey, Vermont, Wisconsin, and Wyoming) had no waiting week in 2011. Wisconsin recently enacted legislation implementing a waiting week beginning in January 2012. The remaining states all have a waiting period of one week's duration.

Question: What reasons are given for having waiting weeks?

Answer: The main argument for waiting weeks is basically as a means of reducing costs of UI programs. Those supporting waiting weeks typically point out that workers get a paycheck in the week following their layoffs and can better afford a week without income at that stage in their period of unemployment. Another argument is administrative convenience. In the early days of UI, waiting periods of two and even four weeks were not uncommon in state UI laws, due to cost concerns and administrative necessity, as prompt claims payments were not feasible in those early days. By the 1960s, however, no state had a waiting period over one week in length, and a few states had no waiting week. As prompt claims payment gained importance, more states repealed waiting weeks. By 1980, a majority of states did not have waiting weeks.

Congress passed an amendment to the federal-state Extended Benefits law in 1980. At that time, states without waiting weeks became financially responsible for paying 100 percent (rather than 50 percent as usual) of the first week of Extended Benefits. In the next year, 16 states adopted a waiting week. Since the early 1980s, there has been little further legislative activity on waiting weeks. Recently, waiting-week proposals have been revived, with Wisconsin adopting one in 2011.

Question: What are the arguments against waiting weeks?

Answer: Most individuals working for a living do not have sufficient savings to sustain their families' spending for essential goods and services in the event of job loss. Jobless individuals and their families already wait 21 days or more to get their first UI check with an uncontested claim. Most state UI programs replace only half of workers' pre-layoff wages at most, with workers who receive maximum weekly benefits getting even lower wage replacement. As a result, in 2010, weekly benefits replaced on average only one-third of pre-layoff wages for U.S. workers. Therefore, asking families to suffer the additional burden of losing even that meager level of income replacement for an additional week is a recipe for hardship in many cases.

The public policy underlying UI programs is to boost the economy by maintaining consumer spending during layoffs. The introduction of a waiting week across all 50 states in 2010 would have caused nearly half of all UI claimants to lose one week of benefits.

Source:

U.S. Department of Labor, Comparison of State Unemployment Insurance Laws (2011).

Unemployment Insurance Weekly Benefit Formulas

Question: How do states calculate unemployment insurance (UI) weekly benefit amounts?

Answer: Each state uses a one-year look-back period called a “base period” or “base year” to determine if the jobless worker has sufficient recent wages to gain monetary eligibility. States have flexibility in setting these wage levels and in developing formulas for determining workers' weekly benefit amount and duration of benefits. In all states, a worker's weekly benefit amount varies based on the worker's past wages so as to replace a portion of lost wages within minimum and maximum benefit limits set by state law.

Each state uses a formula that seeks to replace a fraction (normally about one-half) of a worker's lost wages as measured during that worker's base period. Most states use one of four main formulas, each designed to ensure that benefit payments are based on that worker's customary pattern of full-time work; although, some states' laws provide a choice of formulas. Twenty-nine states use the “high-quarter” formula, which determines weekly benefits as a fraction of wages in the highest quarter of earnings in the base period. Although most states use the same fraction of high-quarter wages for all benefit levels, some favor a weighted schedule that uses a larger share of high-quarter wages for lower-wage workers. As a result, lower-wage workers get higher wage replacement levels in those states.

Twelve states use the “multi-quarter” formula, which most often uses a fraction of wages in the two highest quarters. Six states use the “annual-wage” formula, which bases benefits on a fraction of annual wages. Five states use the “average-weekly-wage” formula, which uses a fraction of average weekly wages in the base period to determine benefit amount. Annual-wage and average-weekly-wage formulas can result in significantly lower benefits for many jobless workers whose earnings varied due to part-year employment or wage variations caused by reduced hours of employment.

Question: What is the range of minimum and maximum weekly benefit amounts in the states?

Answer: Minimum benefit amounts in the states range from \$5 to \$135 per week (excluding dependent allowances available in some states). Maximum weekly benefits range from \$133 (Puerto Rico) to \$625 per week (excluding dependent allowances available in some states). State maximum benefit levels can be set as a fixed dollar amount or indexed to that state's average weekly wage. In 35 states, the maximum benefit is indexed to between 47.6 percent and 75 percent of the state's average weekly wage. Indexing allows benefit amounts to grow in line with a state's wage growth and keep pace with cost-of-living increases. The bipartisan Advisory Council on Unemployment Compensation recommended in its 1995 report that states set their maximum weekly benefit to equal two-thirds of a state's average weekly wage with durations of six months. States that do not have automatic adjustments in benefit levels must rely upon state lawmakers to make adjustments, meaning that the value of the maximum benefit is likely to erode over time relative to wages and the cost of living.

Question: Can a change to a state's benefit formula amount to a cut in benefits for workers?

Answer: Yes. If a state that currently uses a high-quarter formula moves to a multi-quarter formula or a formula based on wages over the entire base period, workers can experience a significant cut in their weekly benefit amount. Workers who work only part of the year, those who have irregular schedules, or those who have uneven earnings due to seasonal fluctuations are most affected by such a change.

For example, a worker with base-period earnings of \$12,500 who has high-quarter earnings of \$7,500 but only \$2,500 of earnings in the next highest quarter would qualify for \$288 per week in a high-quarter state. The worker's weekly benefit would fall to \$192 in a state that uses the two highest quarters of earnings and to only \$120 in a state that uses all four quarters.

Sources:

Advisory Council on Unemployment Compensation, *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (February 1995).

U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws* (2011).

Seasonal Work and Unemployment Insurance

Question: What is seasonal work?

Answer: Seasonal work describes a job that exists for a specific time period, usually defined by the impact of weather or underlying business conditions on the business. For example, ski resorts operate in the winter and agricultural work is concentrated in the warmer seasons in many states. Construction and retail employers often have seasonal employees as well.

Because seasonal employment is not offered year round, seasonal workers typically experience unemployment during the “off season” when their seasonal employers cannot offer them work. As a result, seasonal employers face higher unemployment insurance (UI) tax rates under experience-rating mechanisms that raise tax rates whenever former employees of a firm draw jobless benefits. However, because seasonal work by its nature is limited in duration, seasonal employers’ payroll taxes do not fully compensate trust funds for UI benefits drawn by their employees. In effect, seasonal employers use off-season UI benefits to subsidize their limited labor utilization patterns. In response, some states have enacted seasonality provisions that limit seasonal workers’ ability to draw UI benefits during the off season.

Seasonality provisions in state UI laws vary. Despite calls for seasonal exclusions by some employers, most states have no specific statutes or regulations outside of what is mandated by federal UI law. As a result, seasonal employees draw UI benefits on the same basis as other employees in most states.

Question: How do states determine which employers are seasonal?

Answer: The first step in developing a seasonality provision requires that states define “seasonal.” Currently, states with seasonality provisions rely upon one or a combination of the following factors:

- Industry, employer, or occupation type;
- Length of employer operating period;
- Type of worker.

Industries generally receive seasonal classification based on the length of operation as defined by state laws. Employees in seasonal industries receive the same designation by fact of employment in that industry. However, some states have additional requirements for both industries/employers and workers affected by seasonal classifications. In some instances, employers must also verify that certain proportions of their workforce or payroll are reserved exclusively for a seasonal operating period. States may also require employees to earn a specified amount of wages in seasonal work before drawing UI benefits during the designated seasonal period.

Question: How many states have seasonal work laws?

Answer: Currently, only 15 states have seasonal provisions in their state UI laws. Since the early days of UI, seasonal work has been a subject of debate. The overall number of states with seasonality provisions has declined over the decades. According to Saul Blaustein, author of a leading UI history, during the beginning years of UI programs, as many as 33 states adopted special laws limiting benefits for workers laid off from seasonal work. Blaustein said that these seasonal work limitations were motivated by fears that UI benefits paid to seasonal workers would be a drain on state trust funds and concerns that seasonal employers would face unduly high tax rates under experience rating. By 1971, more than half the states that had experimented with seasonality provisions had abandoned them. The number of states with seasonality provisions dropped to only 13 in 1990. Currently, 15 states (Arkansas, Arizona, Colorado, Delaware, Indiana, Maine, Massachusetts, Michigan, Mississippi, North Carolina, Ohio, Pennsylvania, South Dakota, Wisconsin, and West Virginia) have seasonality provisions.

While the total number of states with seasonality provisions has shifted downward over time, with some states experimenting with the provisions and others repealing them, seasonality provisions remain an active area for proposed legislation. In 2011, ten states introduced some type of seasonal work legislation. Most of the bills sought to implement a new law or amend an existing one. In Maryland, a bill was passed to formally study the issue. The one bill to successfully pass was in South Carolina. That state passed legislation that makes it easier for employers, and their employees, to be classified as seasonal. In general, seasonal workers do not receive benefits during the off season if there is a reasonable assurance of work at the beginning of the next season. Beginning on January 1, 2012, South Carolina employers who operate during a regularly recurring period (or periods) of 36 consecutive weeks may be designated as seasonal.

Question: What are the main arguments in favor of seasonal work laws?

Answer: Saul Blaustein reports that early seasonal work limitations were motivated by fears that UI benefits paid to seasonal workers would be a drain on state trust funds and concerns that seasonal employers would face unduly high tax rates under experience rating. Similar concerns motivate contemporary advocates of seasonality provisions. Experience rating produces two related objections to seasonal work from employers. First, seasonal employers complain of their higher UI payroll tax rates. Second, non-seasonal employers complain about the degree to which they bear social costs for seasonal benefits that are not recovered from seasonal employers. While initially plausible, neither rationale for restricting UI benefits for seasonal workers holds up under serious scrutiny.

The objections of seasonal employers to higher costs are based upon the false assumption that because they are not “at fault” for seasonal work patterns, they should not bear higher costs related to that pattern of seasonal layoffs. However, experience rating is not based upon a concept of employer fault. In fact, the central rationale for experience rating is higher tax rates

for employers that have laid-off employees due to economic conditions. Proponents of experience rating do not characterize employers forced to lay off employees as bearing “fault” for those layoffs. But, under experience rating, their UI tax rates increase without respect to their lack of fault. Seasonal employers can object to higher UI tax rates, but those complaints should be directed against the legitimacy of experience rating rather than the inclusion of seasonal workers in UI programs.

The objection to seasonal workers getting UI benefits from non-seasonal employers concerns the fact that no experience rating mechanism captures 100 percent of costs. And, in the case of seasonal employment, this cost-shifting is often even more prevalent than with other types of employment. But, the fact that some social costs are created is not a compelling reason for denying UI benefits to seasonal workers. They are involuntarily unemployed when laid off at the end of a season. So, while the degree to which social costs are shifted to other employers is dictated by the experience-rating mechanism created by each state law, 100-percent-effective charging is neither practical nor desirable. Indeed, 100-percent experience rating would put some employers, both seasonal and non-seasonal, out of business.

Question: What are the main arguments against seasonal work laws?

Answer: Practical experience in the majority of states indicates that seasonality provisions are not necessary to deal with seasonal work. Expert opinion agrees. The Advisory Council on Unemployment Compensation (ACUC), a presidentially appointed, bipartisan group that met from 1993 through 1995, studied state seasonality provisions. In its 1995 report, the ACUC recommended that states repeal seasonal work exclusions and subject seasonal employees “to the same eligibility requirement as all other unemployed workers.” Saul Blaustein concludes his discussion of seasonal work with a similar recommendation.

Given these competing considerations, NELP believes that the best approach to state seasonality provisions is not to have them. In short, involuntary unemployment is what UI programs are primarily concerned with, and seasonal employment involves involuntary unemployment that should be compensated under UI programs. In some cases, employers are required to have seasonal employment patterns and they need to employ workers in those seasonal jobs. Limiting UI benefits to seasonal employees shifts too much of the burden of seasonal employment upon the employees, who are no more responsible for their seasonal unemployment than other laid-off employees who are unquestionably eligible for UI benefits.

Sources:

Advisory Council on Unemployment Compensation, *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (February 1995).

Leo G. Rydzewski, et al., "Seasonal employment falls over past three decades," *Monthly Labor Review* 116, no. 7 (July 1993): 3–14.

Merrill G. Murray, *The Treatment of Seasonal Unemployment Under Unemployment Insurance* (Upjohn Institute, 1972).

Saul Blaustein, *Unemployment Insurance in the United States: The First Half Century* (Upjohn Institute, 1993).

U.S. Department of Labor Comparison of State Unemployment Insurance Laws (2011).

William Haber and Merrill G. Murray, *Unemployment Insurance in the American Economy* (Richard D. Irwin, Inc. 1966).

Chapter 2

Challenges to Unemployment Insurance as Earned Benefits

Redefining “Suitable-Work” and Job-Search Rules for Unemployment Insurance

Question: What are job-search rules?

Answer: In every state, jobless workers must be able to work and be available for work in order to receive unemployment insurance (UI) benefits. Being able and available for work is a condition that must be met each week to maintain eligibility for unemployment benefits. In line with this requirement, in most states, workers must register for work at their local employment office and actively seek work each week. Workers who refuse to accept “suitable work” without good cause lose their UI benefits.

Because there are only skeletal federal standards for benefits in terms of qualifying requirements, states enjoy a good deal of flexibility in establishing and enforcing job-search rules. One method that states use to establish work-search rules is to require, by statute or administrative rule, workers to make contact with potential employers each week. Most states do not require a strict number of employer contacts each week, rather choosing to require the number of contacts “customary for the occupation” or “as directed.” For the states that do require a specific number of contacts, they range from one to five contacts per week.

Question: What is “suitable work”?

Answer: When a jobless worker is collecting UI, federal regulations (20 CFR 604.5) provide that an individual may limit availability to jobs that are considered suitable for the individual as defined by state law. While states have varied definitions of what is considered “suitable work,” their laws generally consider factors such as the risk to a worker’s health, safety, and morals; the individual’s education, prior training, and earnings; duration of unemployment and potential for obtaining work in one’s customary occupation; and commuting distance of available work. States generally apply an analysis of these factors to each individual worker’s case in determining if there is a refusal of work.

Question: Are there limits to how states may define suitable-work rules?

Answer: Yes. Federal UI law provides guidelines related to the kinds of jobs that workers can be made to accept as suitable. The Federal Unemployment Tax Act (FUTA) provides that states must consider labor market conditions and comply with certain labor standards in designing their suitable-work laws. During times of high unemployment, when state UI trust funds are strained, there can be political pressure to reduce costs by redefining suitable-work laws to make them more restrictive.

Section 3304(a)(5) of FUTA limits the type of work an individual must accept when receiving unemployment compensation. It says in relevant part:

Compensation shall not be denied in such State to any otherwise eligible individual for refusing to accept new work under any of the following conditions:

(A) if the position offered is vacant due directly to a strike, lockout, or other labor dispute;

(B) if the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality;

(C) if as a condition of being employed the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor organization.

The second of these labor standards provisions, which is known as the “prevailing conditions of work” standard, was designed to ensure that the UI program does not undermine existing labor standards by exerting downward pressure on those labor standards. In other words, if unemployed workers were forced, through denial of benefits, to take work whose conditions were less favorable than what is generally available in the locality, this could easily lead to a race to the bottom in terms of wages, hours, and other working conditions.

Question: What is the most common way that states make suitable-work laws more restrictive?

Answer: The most common way that states make their suitable-work laws more restrictive is by expanding the types of work that are considered suitable as the duration of an individual’s unemployment increases. Most commonly, this is done by restricting consideration of suitability to a comparison of wages and lowering the wage that would be considered suitable as weeks of unemployment pass. These revised wage comparisons can be based on the individual’s prior wage, weekly benefit amount, or even the minimum wage.

State restrictions vary widely in their specificity and severity. For example, in Idaho, individuals are required to expand their work search beyond their customary occupation and accept a lower wage as their unemployment spell drags on, without the law detailing any week or wage parameters. On the other hand, Wyoming has one of the most severe restrictions in that it considers a job that pays 50 percent of a worker’s prior earnings as suitable work after only four weeks on unemployment. See Table 1, for more detail.

Table 1. Suitable-Work Laws by Duration of Unemployment

State	Duration of Unemployment Suitable-Work Laws
Florida	After 25 weeks, suitable work is minimum wage and 120% of weekly benefit amount
Georgia	After 10 weeks, suitable work is minimum wage and 66% of high-quarter earnings
Idaho	Individual is expected to expand search beyond customary occupation and accept a lower pay rate as unemployment weeks increase
Iowa	Suitable work is 100% of high-quarter wage for first 5 weeks, 75% for weeks 6–12, 70% for weeks 13–18, and 65% of high-quarter wage after 18 weeks
Louisiana	Suitable work is 60% of highest wage during base period
Maine	After 12 weeks, prior wages are not considered for suitable work
Michigan	Suitable work is 70% of gross pay prior to unemployment
Montana	After 13 weeks, suitable work is 75% of prior wage, but not less than minimum wage
North Dakota	After 18 weeks, suitable work is equal to maximum weekly benefit amount
Utah	Work more likely to be considered suitable as the individual remains unemployed for a longer period of time and as prospects of securing local employment in his or her customary occupation diminish
Wyoming	After 4 weeks, suitable work is 50% of prior compensation

Source: U.S. Department of Labor, Comparison of State UI Laws (2011).

Question: What is the most common way that states make job-search rules more restrictive?

Answer: States make work-search rules more restrictive by requiring a larger number of employer contacts per week and increasing documentation requirements. For instance, beginning August 1, 2011, each week, UI claimants in Florida must provide the state agency with detailed information regarding contact with at least five prospective employers or the date on which he or she accessed services at a one-stop career center.

Question: What reasons are given for requiring stricter suitable-work or job-search requirements?

Answer: Proponents of stricter suitable-work laws and job-search rules often believe that UI benefits are preventing workers from accepting available work. They contend that tightening these rules help workers to get back to work even if it means taking lower-paying work. For this reason, these restrictions are touted as cost-saving measures.

Question: What are the arguments against requiring stricter suitable-work laws and job-search rules?

Answer: Restrictive suitable-work provisions go hand in hand with stricter job-search rules to undermine the ability of UI to both mitigate the economic blow of involuntary unemployment and preserve the laid-off workers' bargaining ability in the labor market. UI was designed to allow workers a reasonable period of time to find replacement work that supports their standard of living and utilizes their highest level of skill.

For UI claimants who were previously employed in higher-wage professions, the prevailing wage rate may be two to three times that worker's weekly benefit amount. Nationally, the average weekly UI benefit is just under \$300, while the average weekly wage is nearly \$900. By requiring a worker to accept work paying a fraction of prior wages or risk disqualification, states depress labor standards and drive down wages for all workers.

Sources:

Christopher J. O'Leary, "UI Work Search Rules and Their Effects on Employment" (Upjohn Institute for Employment Research, 2004).

Christopher J. O'Leary, "State UI Job Search Rules and Reemployment Services," *Monthly Labor Review* 129, no. 6 (June 2006): 27–37.

U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws* (2011).

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U.S. Department of Labor, *Unemployment Compensation Program Letter No. 130, Principles Underlying the Prevailing Conditions of Work Standard*, (1947).

U.S. Department of Labor, *Unemployment Insurance Program Letter 41-98* (1998).

U.S. Department of Labor, *Unemployment Insurance Program Letter 41-98, Change 1* (2000).

Georgia Work\$ and Training Programs Using Unemployment Insurance to Fund “Training” and Work Activities for Claimants

Question: What is Georgia Works?

Answer: Georgia Works is a program initiated in 2003 by the Georgia Department of Labor, without legislative authorization, that used unemployment insurance (UI) benefits to subsidize on-the-job “training” of no more than 24 hours per week by jobless claimants for a period of up to six weeks. Employers accepting Georgia Works placements do not pay participants wages for the time spent working, and they do not agree to hire participants at the end of the “training” period. Instead of wages, individuals participating in Georgia Works are treated as volunteers who receive training with an employer and UI benefits. In addition to UI benefits, Georgia Works participants receive a stipend of up to \$600 (an average of \$100 per week) for expenses such as child care and transportation. This stipend is paid from non-UI funds.

Question: Have other states implemented similar training programs subsidized by UI benefits?

Answer: Similar programs already exist in New Hampshire and Missouri, and several other states have expressed interest in following suit.

Question: Does Georgia Works comply with the Fair Labor Standards Act (FLSA) and federal UI laws?

Answer: Despite some changes made to the program in 2010, NELP still has serious concerns with the Georgia Works model and similar programs that rely on the individual’s UI benefits to provide free labor to private- and public-sector employers.

In December 2009, NELP wrote to the U.S. Department of Labor (USDOL) and requested a review of the Georgia Works program’s compliance with the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq* (FLSA) and federal unemployment law. Specifically, under FLSA, workers in the Georgia Works program must be paid at least the minimum wage for all hours worked unless the program fits one of the exceptions that distinguish “training” from “employment” from the Supreme Court’s 1947 decision in *Walling v. Portland Terminal Co.*, which is now part of the FLSA.

According to USDOL’s Wage and Hour Division, a worker must meet the following six criteria to be considered a trainee:

1. The training, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in a vocational school or academic environment;
2. The training is for the benefit of the trainees;
3. The trainees do not displace regular employees, but work under close supervision of existing staff;

4. The employer providing the training derives no immediate advantage from the trainees' activities, and on occasion its operations may actually be impeded;
5. The trainees are not necessarily entitled to a job at the conclusion of the training period; and
6. The employer and the trainees understand that the trainees are not entitled to wages for the time spent in training.

Participants in the Georgia Works program as originally conceived fail to meet most of these factors. For example, some workers have been reported to be performing less-skilled work that benefits the employer. Also, the program has been characterized as a job tryout by some state officials and seems to lack any separate training comparable to what is provided at a vocational school.

Under federal UI law, employers in states that comply with the requirements of federal law receive a partial credit against federal UI taxes. As part of the federal framework, all states are required to include in their state UI laws provisions that set up a separate UI trust fund.

For purposes of this chapter, the term "unemployment fund" means a special fund, established under a State law and administered by a State agency, for the payment of compensation. . . . no part of [which]...[can be] expended for any purpose other than the payment of compensation (exclusive of expenses of administration) and for refunds of sums erroneously paid into such fund and refunds paid in accordance with the provisions of section 3305 (b). 26 U.S.C. §3306(f) (emphasis added).

According to Section 3306 of the Federal Unemployment Tax Act (FUTA), the definition of "compensation" is "cash benefits payable to individuals with respect to their unemployment." 26 U.S.C. §3306(h) (emphasis added).

In addition, both the Social Security Act and FUTA contain "limited withdrawal" standards that guarantee that funds in state UI trust funds are only withdrawn to pay UI benefits (and a few other statutorily permitted uses not applicable here). Here are the relevant provisions of FUTA:

Approval of State laws—(a) The Secretary of Labor shall approve any State law submitted to him, within 30 days of such submission, which he finds provides that—

* * * *

(4) all money withdrawn from the unemployment fund of the State shall be used solely in the payment of unemployment compensation, exclusive of expenses of administration, and for refunds of sums erroneously paid into such fund and refunds paid in accordance with the provisions of section 3305 (b). 26 U.S.C. §3304(a)(4) (emphasis added). See also 42 U.S.C. § 503(a)(5).

These interrelated federal provisions are intended to ensure that state UI payroll taxes are kept in trust funds and "solely" withdrawn as compensation paid to individuals with respect to their

unemployment. USDOL has previously summarized the impact of the federal withdrawal standards: “Under the withdrawal standard, moneys may be withdrawn from the State's unemployment fund only for the payment of UC (or another statutorily permissible use). . . .”

Clearly, participants in Georgia Works are not being paid UI benefits “with respect to” their unemployment while participating in the program. Instead, they are being paid UI benefits for time spent each week performing services for participating Georgia Works employers. Because claimants in Georgia Works are performing services for up to 24 hours a week, they are not “unemployed” for any time spent participating in Georgia Works. And, if Georgia Works participants are not unemployed, they cannot be paid “compensation” with respect to their unemployment for any time spent engaged in providing services to Georgia Works employers. Accordingly, any UI benefits paid to claimants in Georgia Works are not made in conformity with the federal withdrawal standard.

In January 2010, USDOL issued Training and Employment Guidance Letter 12-09, which provided some basic parameters addressing compliance with both FLSA and federal UI law when establishing a work-based training program. Unfortunately, since issuing that guidance, USDOL has taken a low-profile approach to Georgia Works and similar state programs, and the Administration included a Bridge to Work program with somewhat stronger employee protections in its American Jobs Act proposal.

Question: What are the main arguments in favor of subsidized work-based training programs resembling Georgia Works?

Answer: Proponents of such programs have described them as a way for workers to get their foot in the door to showcase their skills to new employers, allowing those workers to get back into the workforce more quickly. The program is also praised for its ability to lower employer costs to recruit, hire, and train new workers. Lastly, the program is said to produce a savings for the UI trust fund, as participants return to employment sooner and no longer need benefits. There are no studies confirming any of these claims.

Question: What reasons are the main arguments against subsidized work-based training programs such as Georgia Works?

Answer: Aside from the issues with their basic lawfulness under FLSA and UI law, programs like Georgia Works divert dedicated UI funds to subsidize primarily low-wage jobs. While employers use UI dollars contributed by other employers to get free work from jobless claimants, they have no obligation to provide real training or even consider participants for hiring. There is no prohibition on displacement of other employees of participating employers, meaning that workers that might otherwise perform services for those employers remain without work. Additionally, these types of programs open the door to mandatory work requirements in the UI program, which would be detrimental to workers and the labor market.

After reviewing data on Georgia Works trainees who found employment, economist Eileen Appelbaum found that 70 percent of the trainees hired after the end of the training program found low-wage employment such as low-pay clerical, janitorial, retail, restaurant and other entry-level jobs. In fact, the new Georgia labor commissioner has expressed serious concerns about the program's costs and effectiveness, and new data released by the state calls into question the program's employment impacts.

Some proponents of this model advocate requiring unemployed workers to work for their UI benefits, without regard to the fact that they have already earned these benefits through their previous attachment to the workforce. The "work first" mandate in state welfare programs has no place in UI, which provides income support based exclusively on an individual's past work and wage history, and has for 75 years provided U.S. workers with financial protection during periods of involuntary job loss. Pushing desperate workers into mostly low-wage jobs brings down wages and working standards for all workers.

Sources:

Eileen Appelbaum, "Georgia Works May Work, But it Sure Doesn't Pay" (Center for Economic and Policy Research, September 2011).

U.S. Department of Labor, Training and Employment Guidance Letter No. 12-09 (2010).

Mandatory Community Service and Unemployment Insurance

Question: Can states require community service as a condition of receiving unemployment insurance (UI) benefits?

Answer: No. While states have considerable flexibility in the design of their individual UI programs, state law governing the program must fit within the framework of federal unemployment compensation law. There are federal conformity issues with states requiring unemployed workers to perform a set number of hours of community service work each week as a condition of UI eligibility. Since the federal–state UI program was established, federal law has clearly limited payment of UI benefits; they may be paid only “with respect to” an individual’s unemployment. In other words, states may not restrict benefit receipt based upon conditions unrelated to the fact or cause of a worker’s unemployment.

When Congress created the program, it intended for the program’s scope be limited to compensation for an individual’s involuntary unemployment. A 1935 Senate report on the original Social Security Act (SSA) differentiates unemployment compensation from other programs. Specifically, the report states that UI “differs from relief in that payments are made as a matter of right not on a needs basis, but only while the worker is involuntarily unemployed.”

In a 1964 conformity decision, the secretary of labor pointed to the intent of Congress to explain why a South Dakota state law that imposed a means test on unemployed workers was inconsistent with the “withdrawal standard”:

If the language of the Federal law is not in itself sufficiently plain to preclude the application of the income-from-earnings test as a condition of entitlement un-related to the fact or cause of unemployment, one need look only to the intent of Congress and its mandate for “genuine unemployment compensation laws” for the principle that unemployment compensation is to be paid as a matter of right without any test of means or other condition of entitlement not reasonably related to the insurance program or to the insured risk, involuntary unemployment.

This intent is further codified in the “withdrawal standard,” which can be found in the Federal Unemployment Tax Act (FUTA) and the SSA. Section 3304(a)(4) of the FUTA says money withdrawn from the unemployment trust fund must be “used solely in the payment of unemployment compensation.” States must comply with the withdrawal standard in order for employers to receive a credit against the FUTA tax.

Additionally, Section 303(a)(5) of the SSA establishes the same withdrawal standard as a requirement for states to receive administrative funds. The fact that a state’s unemployment trust fund can only be used to pay benefits is further outlined in Section 3306(h) of FUTA, which defines compensation as “cash benefits payable to individuals with respect to their

unemployment.” These related, statutory provisions underlie the Labor Department’s longstanding objections to tying receipt of unemployment benefits to reasons that are unrelated to unemployment. In short, UI is earned through prior employment and paid in relation to subsequent involuntary unemployment and attachment to work. Other conditions should be unlawful.

Question: How many states require community service of UI claimants?

Answer: Although lawmakers in several states introduced such legislation in 2011, thus far, no state has a law requiring community service work from UI claimants as a condition of eligibility.

Question: What reasons are given for requiring community service of UI claimants?

Answer: Proponents of mandatory community service work for UI claimants have given various reasons for their legislation. Some lawmakers insist that the unemployed should give back to the community as a way of earning their benefits. Others have said the volunteer work is an opportunity for the unemployed to network, learn a new skill, or just get out of the house. Still others have questioned the work ethic of unemployed workers.

The UI program already assesses a worker’s connection to the labor force. In fact, state statutes governing eligibility and disqualification are designed to ensure that workers who collect benefits were previously attached to the labor force and have the capacity to rejoin it. The UI program is meant to provide a modest wage replacement for eligible individuals during a period of unemployment. In order for an involuntarily unemployed individual to be entitled to benefits, he or she must show an attachment to the labor force as measured by a threshold amount of wages earned prior to job loss. In addition, the worker must be able and available for work each week that benefits are collected. The claimant must also search for work and be willing to accept suitable offers of work.

Question: What are the arguments against community service requirements for UI claimants?

Answer: While volunteering has many benefits, UI eligibility conditions must be related to the “fact or cause of unemployment.” By mandating community service for UI claimants, states risk losing the administrative funding they use to run their programs. Additionally, such a mandate would put a state’s program out of conformity with federal law, and that state’s employers would then no longer be eligible for their FUTA tax credit of \$378 per employee.

Sources:

U.S. Department of Labor, Training and Advisory Guidance Letter No. 12-09 (2010).

U.S. Department of Labor, Unemployment Insurance Program Letter No. 787 (1964).

Drug Testing as a Condition of Receiving Unemployment Insurance

Question: Can states require passage of a drug test as an initial condition of eligibility for receiving unemployment insurance (UI) benefits?

Answer: No. States may not restrict initial benefit eligibility based upon conditions unrelated to the fact or cause of a worker's unemployment (see the section on community services and UI for more details). Under certain circumstances, drug testing *may* be permissible as a condition of continuing eligibility, but the implementation of such testing must still conform to federal unemployment compensation law. There are two main areas where conformity issues for drug testing as a condition of continuing eligibility often arise. First, state lawmakers often propose legislation that burdens workers with covering the cost of drug testing. States can also run into federal conformity issues when they set disqualification penalties for failing the test or refusing to submit to testing.

State agencies are funded largely or entirely by UI administrative grants from the U.S. Department of Labor. Since the Labor Department does not reimburse states for the additional expense of drug testing as an approved administrative cost, lawmakers have proposed various options that shift the cost of drug tests onto unemployed workers. One option they have proposed is to deduct the cost of the test from claimants' benefits. Another option would be to require that the claimant pay for the test out of pocket as an upfront cost. The Federal Unemployment Tax Act (FUTA) and the Social Security Act (SSA) both require that state UI trust funds be used only for payment of benefits. Additionally, the SSA prohibits a state from assigning the cost of administering its program to claimants.

Specifically, section 3304(a)(4) of FUTA restricts the use of money withdrawn from the unemployment trust fund, specifying that it be "used solely in the payment of unemployment compensation." This withdrawal standard is a condition that a state must meet in order for employers to receive a credit against the federal unemployment tax. Additionally, section 303(a)(5) of the SSA establishes the same withdrawal standard as a stipulation for states to receive administrative funds. The fact that a state's unemployment trust fund can only be used to pay benefits is further outlined in section 3306(h) of FUTA, which gives the definition of compensation as "cash benefits payable to individuals with respect to their unemployment." Whether withdrawn directly from the trust fund or deducted from a worker's benefit, the expense of administering a drug test is not a cash benefit with respect to a worker's unemployment.

Moreover, section 303(a)(1) of the SSA establishes that state law must outline methods of administering the UI program that ensure "full payment of unemployment compensation when due." These methods of administration are a requirement for states to receive their federal administrative grant. The U.S. Department of Labor has construed this section to mean that a

state may not transfer the costs of administering the state law to the claimant. Charging a worker more than *de minimus* cost for drug testing would be passing the cost of administration along to the worker and would endanger a state's federal UI administrative funding.

Lastly, some state drug testing legislation includes a provision to completely disqualify workers who fail a drug test or refuse to take one. Federal law specifies only three reasons that an individual may be totally disqualified from benefits. According to section 3304(a)(10) of FUTA, total reduction of benefit rights is limited to discharge for work-related misconduct, claims fraud, or the receipt of disqualifying income. Failing a drug test or refusing to take one does not meet any of these conditions.

Question: How many states require drug testing of UI claimants?

Answer: To date, no state requires drug testing of UI claimants as a condition of either initial eligibility or week-to-week eligibility. However, 20 states currently have provisions that classify any job loss connected to drug use or a failed drug test as willful misconduct. It is important to note that the remaining states would also likely treat a drug-related discharge as disqualifying misconduct even though it is not explicitly referenced in their discharge statutes. Thus, states already restrict eligibility for workers whose job loss is related to drug use. In 2011, two additional states (Indiana and Wisconsin) made changes to their UI law to equate a failed or refused pre-employment drug screen with refusing suitable work.

Question: What reasons are given for drug testing of UI claimants?

Answer: State lawmakers often claim this legislation is designed to deter drug use among the unemployed. They cite the prevalence of employer drug-free workplace policies and the use of a drug test as a pre-employment screening tool as evidence of the need for unemployed workers to be screened as a condition of receiving benefits. The other reason states have given is cost. They assume there will be significant savings from benefits that are not paid to workers who fail the tests.

However, this broad approach may be rooted in a blanket assumption voiced by some policymakers that unemployed workers are to blame for their unemployment and in mean-spirited efforts to paint the unemployed as lazy drug abusers. It is important to note that the UI program is designed to assist workers who have lost their jobs involuntarily, generally for economic reasons. These workers have not found new jobs because there simply are not enough jobs being created. As of June 2011, the ratio of unemployed workers to job openings has been more than four to one for two-and-a-half years. Drug testing every unemployed worker that qualifies for benefits is a misguided and overbroad remedy for states struggling with insolvent trust funds.

Question: What are the arguments against drug testing UI claimants?

Answer: The primary reason that no state has enacted legislation to drug test unemployed workers is cost. As a conservative figure, the Substance Abuse and Mental Health Services Administration (SAMHSA) estimates that the cost of drug testing is between \$25 and \$75 per test. Given the federal law conformity issues raised by attempting to assign the cost of testing to claimants, it would be very costly if a state had to absorb the cost of drug testing thousands of unemployed workers. In March 2011, the Texas Legislative Budget Board produced a fiscal note examining the cost of implementing a program to drug test the unemployed in that state. The Board estimated the full-year cost of implementing such a program to be nearly \$30 million. This included over \$27 million just for the drug testing vendor alone. Most states have been trimming expenses since the recession began, even making cuts in public education to balance their budgets. Under these circumstances, it is unlikely that lawmakers would be willing to commit millions of general fund dollars to a UI drug testing program.

Source:

U.S. Department of Labor, Comparison of State Unemployment Insurance Laws (2011).

Chapter 3

Business Climate and Economic Impact

Business Climate and Unemployment Insurance

Question: Over the decades, have unemployment insurance (UI) costs risen dramatically for employers, making it necessary to cut benefits rather than increase employer taxes to restore trust fund balances in insolvent states?

Answer: No. Employer UI contribution rates reached a historic low prior to the recession. Between 1995 and 2005, 31 states reduced UI taxes by at least 20 percent. As a result of these tax cuts, UI contributions as a percentage of wages fell to an all-time low during the first decade of the 2000s (**Table 1**). Compared to the 1990s, the percentage of unemployed workers actually receiving benefits remained below 40 percent, and the level of benefits relative to wages (i.e., replacement rate) has been unchanged for decades.

Table 1. Measures of UI Coverage and Employer Costs by Decade			
Decade	Reciency Rate (% of unemployed receiving UI)	Replacement Rate (average weekly benefit as a % of average weekly wages)	Employer Contribution Rate (% of total wages)
1950s	49%	33%	0.98%
1960s	42%	35%	1.10%
1970s	38%	36%	1.00%
1980s	35%	36%	1.11%
1990s	36%	35%	0.76%
2000s	39%	35%	0.65%

Source: Employer contribution and replacement rates are from the U.S. Department of Labor, *Financial Data Handbook* 394. The reciency rate is from the U.S. Department of Labor, *Unemployment Insurance Chartbook*.

Question: How does the cost of UI compare to other employer costs such as wages and benefits?

Answer: Unemployment insurance costs are modest relative to wages and employee benefits. For each dollar of wages earned by workers, businesses pay about one cent in federal and state UI taxes. On average, private-sector workers earn just over \$28 of wages and benefits per hour worked (**Table 2**) of which UI accounts for only \$0.24. Compared with other benefits such as health care and paid leave, UI makes up a small fraction of total compensation. The portion of compensation attributable to UI increased since the start of the recession as a result of

automatic tax increases resulting from insolvent state trust funds. But because UI costs are minor relative to wages and other benefits, the UI-related increase accounted for only \$0.05 of a total compensation increase of \$2.20.

Table 2. Hourly Cost to Businesses of Wages and Benefits			
	2007	2011	Change
Total compensation	\$25.93	\$28.13	\$2.20
Wages and salaries	\$18.32	\$19.81	\$1.49
Other Benefits			
Insurance (i.e., health, life, and disability)	\$1.97	\$2.27	\$0.30
Paid leave	\$1.78	\$1.90	\$0.12
Social Security and Medicare	\$1.54	\$1.66	\$0.12
Retirement and savings	\$0.89	\$1.03	\$0.14
Federal and state unemployment insurance	\$0.19	\$0.24	\$0.05
<i>Unemployment insurance % of hourly compensation</i>	<i>0.73%</i>	<i>0.85%</i>	<i>---</i>

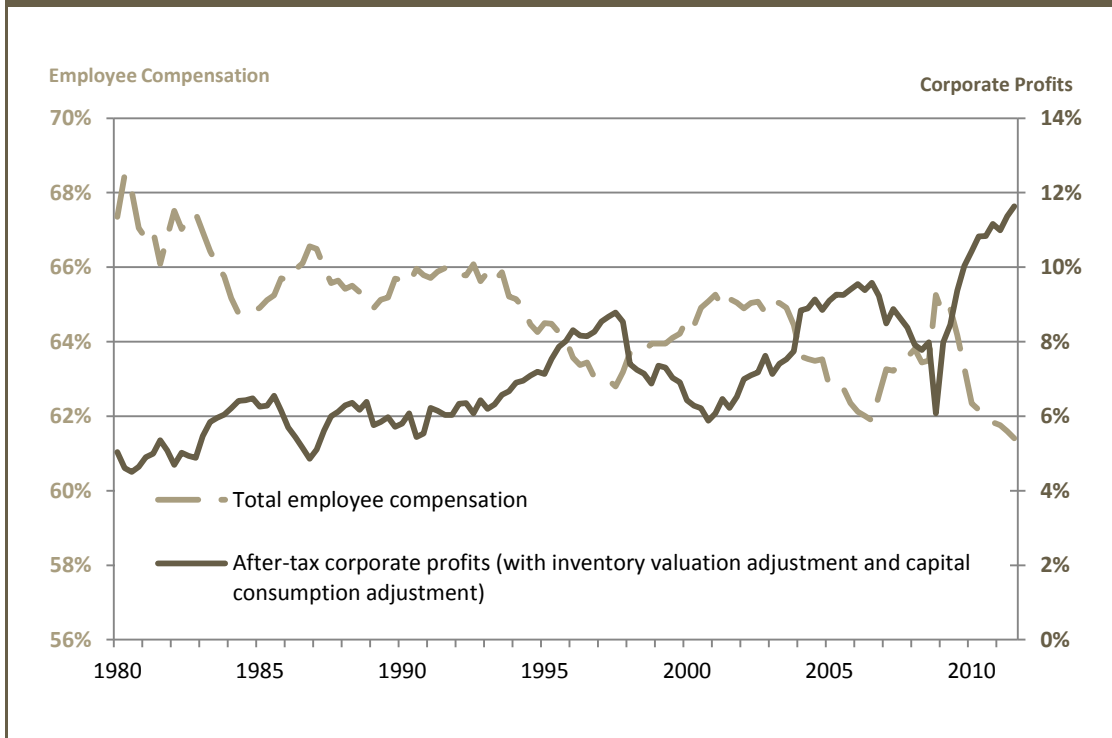
Source: U.S. Department of Labor, Bureau of Labor Statistics, National Compensation Survey: Employment Cost Trends (Table 5. Private industry, by major occupational group and bargaining status), September 8, 2011.

Note: Not all benefits are listed.

Question: How have corporate profits fared during the economic downturn?

Answer: Corporate profits are at an all-time high. After ten consecutive quarters of growth, after-tax corporate profits reached a record high during the second quarter of 2011. Meanwhile, there are still 6.5 million fewer jobs than when the recession started. As a result of rising corporate profits and lagging employment, the share of nation's income going to corporations has doubled since 2008 and is now at a record high (**Figure 1**). In comparison, employee compensation including wages and benefits, as a percentage of national income, has fallen steadily from a historical peak in 1980 to a 45-year low.

Figure I. Corporate Profits and Employee Compensation
Percentage of National Income

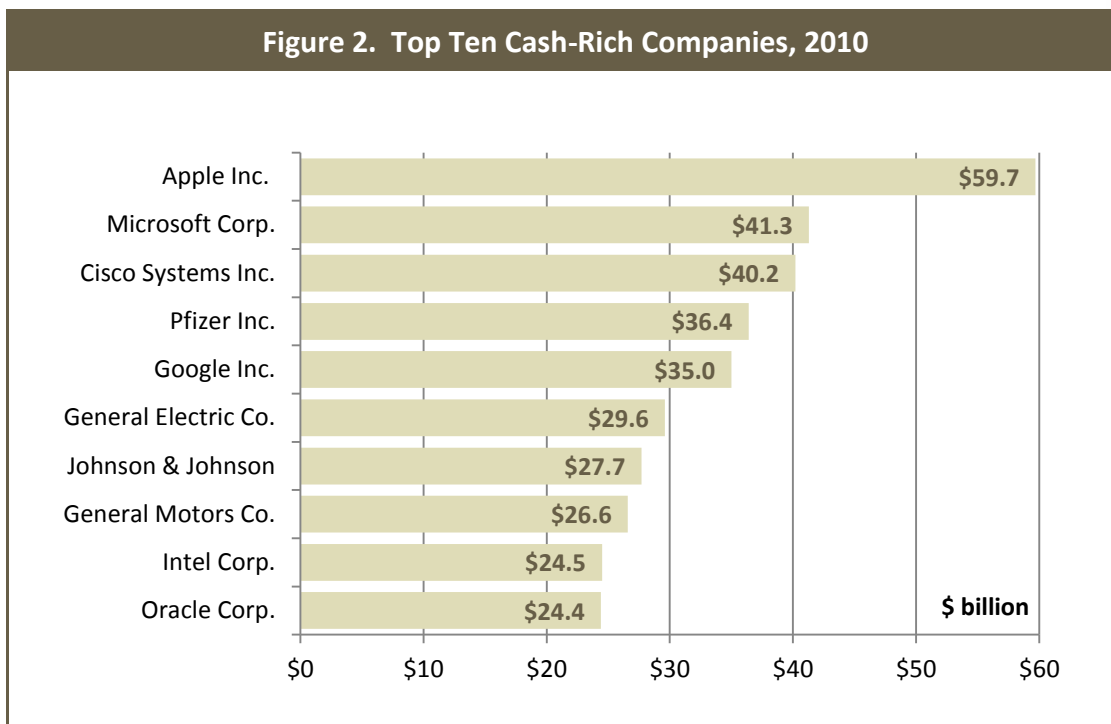


Source: Calculations based on Bureau of Economic Analysis, National Income and Product Accounts Tables (Table 1.12, National Income by Type of Income), Nov. 22, 2011.

Question: Have record corporate profits translated into additional hiring?

Answer: No. Corporations are sitting on \$2 trillion in cash, but historically high corporate profits have not translated into additional hiring. Instead, corporations continue to hoard record levels of cash. Cash balances increased by nearly 50 percent through the nine quarters ending in June 2011, and cash holdings now make up the largest percentage of company assets since the early 1960s.

General Electric, whose Chairman and CEO Jeff Immelt also leads the president's Council on Jobs and Competitiveness, amassed nearly \$30 billion by the end of 2010—one of the nation's largest stockpiles of cash (**Figure 2**). Meanwhile, Apple, the company with the largest cash holdings at the end of 2010, manufactures all of its products in China.



Source: Moody's, US Corporate Cash Pile Rises to \$1.2 Trillion, July 26, 2011 (via National Public Radio, Companies Sit On Cash; Reluctant To Invest, Hire, August 17, 2011).

Sources:

Board of Governors of the Federal Reserve, Z.1 Flow of Funds Accounts of the United States (L.102 Nonfarm Nonfinancial Corporate Business, Total liquid assets), September 16, 2011.

Dale Ziegler and Robert Pavosevich, Introduction to State Unemployment Insurance Trust Fund Solvency, U.S. Department of Labor (March 19, 2010).

Donald L. Barlett and James B. Steele, "Apple's American job disaster," *Philadelphia Inquirer*, November 20, 2011.

Does Unemployment Insurance Discourage Work and Increase Unemployment?

Question: Does unemployment insurance (UI) encourage jobless workers to avoid accepting work and increase the unemployment rate?

Answer: According to a September 2011 study by economist Jesse Rothstein, the answer is not very much. However, some impact from receiving UI benefits should be expected given economic incentives. Rothstein finds that in the absence of extended federal benefits, the unemployment rate would have been about 0.2 to 0.6 percentage points lower in 2010. Over half of the impact of UI found on the unemployment rate was due to UI recipients staying in the labor force and actively searching for work, something that should be seen as a positive impact of UI. Rothstein's study finds a smaller effect of UI, but takes a broader look at UI than earlier papers.

Question: Does UI increase the duration of unemployment?

Answer: Using data from the current recession, economists at the Federal Reserve Bank of San Francisco estimate that federal UI benefits increased the duration of unemployment by 1.6 weeks. Studies of the impact of UI on claimants' unemployment duration have found various estimates of the impact over the years in roughly the same range as this recent study.

Question: Isn't there evidence of a "spike" in the exit rate from unemployment around the expiration of jobless benefits.

Answer: The spike was observed in earlier studies focused on UI payment data. More recently, the magnitude of this "spike" was much smaller in studies by Harvard economist Raj Chetty (and others) where jobless spell lengths were defined as time from job loss to the next job as opposed to time spent in UI programs. Measuring the time to reemployment is a better and more relevant measure of the economic efficiency of unemployment benefits.

Question: How can I frame a response to the disincentive argument?

Answer: Because there is a multitude of data on UI, it is among the most studied benefit programs. Jobless workers are not that different from employed workers, so it is foolish to deny that UI benefits have some impact on behavior. Many earlier studies of UI looked only at the behavior of UI claimants, ignoring the fact that a significant number of jobless workers do not draw UI benefits. These studies also neglected the positive impact that UI has on consumer spending and the overall economy. What amounts to, at most, a few tenths of percent difference in the unemployment rate is a small price to pay for a program that boosts consumer demand while supporting labor market attachment and keeps unemployed workers in their homes and food on their families' tables.

Sources:

Jesse Rothstein, “Unemployment Insurance and Job Search in the Great Recession” (University of California, Berkeley and NBER, September 2011).

Mike Evangelist and Rick McHugh, “Beyond Sound Bites: Understanding the Impact of Unemployment Insurance on the Severity of Unemployment” (National Employment Law Project, May 2010).

Raj Chetty, “Moral hazard vs. liquidity and optimal unemployment insurance,” *Journal of Political Economy* 116: 173–234.

Chapter 4

Financing and Solvency

Experience Rating: Myths and Realities

Question: What is experience rating?

Answer: Experience rating is a process through which UI payroll tax rates on contributing employers are adjusted in relation to layoffs of individual firms' employees or former employees.¹ In other words, as UI benefit payments to a firm's employees rise, tax rates on the firm are increased in subsequent years. Conversely, in the absence of UI benefit payments, UI payroll tax rates on employers fall. Thus, based upon the firm's "experience" with unemployment, its tax rate is more or less determined between the limits set by minimum and maximum rates in state UI law. (In addition to individual firms' experience rates, many states adjust UI payroll taxes according to other factors, including the overall health of trust fund reserves.)

While all 50 states have adopted experience rating in order to satisfy federal requirements, providing a Federal Unemployment Tax Act (FUTA) tax credit for employers whose wages are subject to a state UI experience-rated tax, there is considerable variation in how states have implemented it. First, states vary according to the portion of wages subject to UI taxes (taxable wage base), their minimum and maximum UI tax rates, how fast their tax rates adjust within the resulting range of rates (usually from three to five years), and the experience-rating formula used. Second, the mix of these state policies impacts the degree to which a state's experience-rating method "effectively charges" benefit costs to a particular firm and recovers those costs for its trust fund.²

From the outset, it is important to understand that, in the real world, "perfect" or "complete" experience rating—where every benefit dollar is collected from the specific employer involved—is not possible.³ Nor is complete experience rating desirable. While we explain both these points in more detail later, the simplest explanation is that some firms with high experience would be hurt competitively by UI taxes if they were required to bear the full costs of UI benefits paid to former employees. On the other end of the experience-rating scale, because all employers have employees insured by UI programs, all employers should pay some minimum UI tax (in effect, an insurance premium) to reflect the social benefits of UI programs to each firm, employees, and the overall economy. So, with respect to experience rating, a reasonable goal is to determine the mix of tax policies that a state's policymakers and interest groups find acceptable in order to finance its UI program. An unreasonable goal is to try to keep adjusting UI taxes in a futile effort to reach complete or perfect experience rating or to avoid tax adjustments required to properly finance UI programs.

Question: What is the taxable wage base?

Answer: UI payroll taxes are not imposed on all wages. The portion subject to taxation is referred to as the taxable wage base. During 2011, state taxable wage bases ranged from \$7,000 (the federal minimum) to \$37,300. Fifteen states have taxable wage bases over \$20,000. All states have maximum and minimum UI tax rates. In 2011, minimum tax rates ranged from zero or near zero to 2.68 percent of taxable wages. Maximum UI tax rates ranged from 12.27 percent of taxable wages to 5.4 percent (the lowest maximum rate permitted under federal law).⁴

Seventeen states automatically adjust their taxable wage bases with growth in state wages, a practice called indexing.⁵ Having a higher taxable wage base and indexing that tax base are two important policies that have contributed significantly to states' UI trust funds remaining solvent over the years.⁶ In addition, having a higher taxable wage base permits more effective charging under experience rating, something that many employers and economists claim is a worthwhile policy, but often oppose in practice by arguing for lower rates and lower taxable wage bases.

Question: What are the different types of experience-rating formulas?

Answer: Depending upon the reference consulted, it is generally said that there are four or five experience-rating formulas used by states. These formulas are essentially a method of comparing each experience-rated firm's benefit costs to its payroll or contributions. Formulas vary in terms of how they measure experience, the number of years used in the formula, and the importance of factors used to set rates.

In practice, there are two main experience-rating formulas used by the great majority of states. These are termed the benefit-ratio and reserve-ratio methods. In 2011, 16 states used the benefit-ratio formula, while 34 states were reserve-ratio states.⁷ Several states have hybrid or unique systems. For example, Michigan and Pennsylvania have a variant of benefit-ratio formulas combined with other factors, while Alaska has a unique formula called payroll variation, and Delaware and Oklahoma use a formula called benefit wage ratio.

The *reserve-ratio* method of experience rating takes into account tax contributions over each employer's entire experience, as well as each firm's benefit payments and payroll. Under the reserve-ratio formula, the reserve ratio (benefits minus contributions, usually over the life of the UI program) is divided by each firm's payroll to arrive at a basic tax rate for each firm. In its essence, the reserve-ratio formula is a cost-accounting formula, as each employer's rate is designed to recover that employer's cost to the trust fund over the life of the program.

Typically, in addition to the rate assigned by each firm's reserve ratio, a tax schedule that takes the overall trust fund's reserve balance into account is employed to set each firm's tax rate applied to the state's taxable wage base. When trust fund reserves are lower, the tax schedules are designed to slide upward and increase contributions, and *vice versa*.

Under the *benefit-ratio* method, the amount of benefits paid to a firm's employees over the specified number of past years is compared to the firm's average payroll over those same past years (usually three to five years). The resulting ratio places the firm in a rate class. A social-cost factor, if any, is added to the experience rate set by the benefit ratio, and the overall tax rate for each firm is applied to the state's taxable wage base. The social-cost factor is related to the overall solvency of the state's trust fund. The benefit-ratio formula is thought to provide more assurance of solvency than other methods because it relates contributions directly to benefit costs over a relatively short time frame. Benefit-ratio states are also thought to have more volatile tax rates, due to the shorter time frame used for this experience-rating method.

States also differ in terms of how they charge employers when a claimant has more than one employer in his or her base period. The base period is the four-quarter period that precedes the filing of a claim. Fourteen states charge the most recent "separating" employer, while 34 others charge all base-period employers in proportion to the base-period wages each paid.⁸

Question: What is the experience-rating index?

Answer: Since the 1980s, the U.S. Department of Labor (USDOL) has published an experience-rating index (ERI). The ERI takes into account three different types of uncharged benefits that impact the degree of experience rating in a state. *Ineffective charges* arise mainly from charges to firms that are already at the maximum rate, meaning additional charges cannot be effectively collected. *Inactive charges* are benefits paid to former employees of inactive accounts, mainly firms that are no longer in business. And, *noncharged* benefits are those benefits that are not charged due to the operation of law.

ERI is computed by subtracting from 100 the following: (1) the percentage of ineffectively charged benefits, (2) the percentage of charges to inactive firms, and (3) the percentage of non-charged benefits. The resulting figure provides a rough guide to how completely a state's experience-rating mechanism charges benefits paid in that state. We say rough guide because ERI is an annual figure, and all experience rating methods take a number of years to recapture benefit costs. There is also a lag between when benefits are paid and when taxes to pay those benefits are increased in all experience-rating methods. Because ERI assesses benefits and taxes in an annual snapshot, it will never show that all benefits are charged in a particular year. For these and other reasons,⁹ ERI provides guidance about how a specific state is performing from year to year within its own terms, but does not provide good information for comparing experience rating among states.

Because ERI is a USDOL-published figure, it is sometimes used as a sort of score by proponents of experience rating, as if states with higher ERIs are doing better than states with lower ERIs. Ironically, some of the same observers who call attention to the ERI are less likely to call attention to other annually released measures like USDOL's *adequate financing rate*. Raising a state's adequate financing rate would address a state's forward financing requirements, and some of the steps required to produce adequate financing would indirectly improve ERI scores

as well. However, adequately financing trust funds is significantly more important overall to states than achieving a high ERI score.

Question: Why is complete experience rating not practical?

Answer: In economic theory, taxing layoffs through experience rating influences employer behavior and lowers unemployment. But the degree of influence on employers' actions has varied from study to study. Regardless of its underlying economic theory, the pertinent question regarding experience rating is the degree to which more complete experience rating should be a priority of state policy.

As we already explained, complete experience rating is not a desirable policy because it would impact the competitiveness of high-cost firms, putting some firms out of business. In addition, UI programs should recognize that even no-cost firms derive advantages from having UI programs in place. For that reason, asking firms to pay some minimum contribution for the insurance provided to employees is a valid policy. It follows that zero or very low minimum rates are bad UI financing policy.

There are several reasons built into how experience rating works that ensure that it is not complete. As noted, ineffective charges and inactive charges are a reality in any state. Employers go out of business. Maximum tax rates and taxable wage bases limit how high tax rates can go. And new employers and reimbursing employers are not subject to experience rating.¹⁰ For these reasons, even those that accept conventional wisdom supporting experience rating as a means of lowering unemployment should adopt a measure of humility.

In summary, the idea that more complete experience rating is desirable and that experience rating should be a priority of state policy is a somewhat ephemeral goal. The experience rating method used by each state reflects political as well as policy judgments. Essentially, states are deciding on what basis to raise UI taxes, how quickly to impose higher taxes on employers when benefit payments rise, and how much individual firm responsibility is desirable when allocating those costs among the entire employer community. In the long run, the experience-rating formula used by a state is less important than other UI financing policies. In particular, having higher taxable wage bases, indexing taxable wage bases, establishing more than token levels of minimum tax rates, and retaining a philosophy of forward financing are all more important questions than the degree of experience rating applied in a state or the specific experience-rating mechanism adopted.

Footnotes

¹ The United States is the only highly developed country using experience-rated taxes to finance its UI program. A description of states' experience-rating mechanisms is provided in Advisory Council on Unemployment Compensation, *Unemployment Insurance in the United States: Benefits, Financing, Coverage* (February 1995), 73–89. A survey of research concerning the impact of experience rating on layoffs is found in Phillip B. Levine, "Financing Benefit Payments," in O'Leary, C.J. and Wandner, S.A., *Unemployment Insurance in the United States: Analysis of Policy Issues* (Upjohn Institute, 1997), 347–353. Another study is Stephen Woodbury, "Layoffs and Experience Rating of the Unemployment Insurance Payroll Tax: Panel Data Analysis of Firms in Three States" (Upjohn Institute, September 2003).

² Most state, local, educational, and nonprofit employers do not pay UI payroll taxes. They are so-called "reimbursing employers." These employers are billed quarterly for any UI benefits paid to former employees and are, thus, not subject to experience rating.

³ "The volume of benefits that are 'ineffectively charged' will be reduced by either a higher tax base or higher tax rate, both of which will permit more effective operation of experience rating. There will always be some 'ineffectively' charged benefits because there are practical limits to how high maximum tax rates can be pushed." William Haber and Merrill G. Murray, *Unemployment Insurance in the American Economy* (Richard D. Irwin, Inc. 1966), 352–353.

⁴ U.S. Department of Labor, Office of Workforce Security, "Significant Provisions of State Unemployment Insurance Laws" (July 2011).

⁵ For a list of the 17 states with indexed taxable wage bases, see National Employment Law Project, Briefing Paper: "Indexed State Taxable Wage Bases: Taking A Significant Step Toward Better UI Financing," (February 2004), available at <www.nelp.org>. Louisiana's wage base is subject to being raised or lowered according to its trust fund balance, and this is a solvency measure, not wage base indexing.

⁶ Wayne Vroman, *Topics in Unemployment Insurance Financing*, (Upjohn Institute, 1998), 77–98. Vroman has repeatedly pointed out the importance of these features when examining Washington. See also Levine, "Financing Benefit Payments," in O'Leary, C.J. and Wandner, S. A., *Unemployment Insurance in the United States*, 330–337.

⁷ U.S. Department of Labor, *Comparison of State UI Laws* (July 2011), Table 2-3 and 2-4. NELP considers Michigan and Pennsylvania as hybrid mechanisms, while USDOL treats them as benefit-ratio states.

⁸ U.S. Department of Labor, *Comparison of State UI Laws: 2011*, Tables 2-9 to 2-12.

⁹ For a summary of the limitations of ERI, see Levine, "Financing Benefit Payments," in O'Leary and Wandner, *Unemployment Insurance in the United States*, 340–343.

¹⁰ Another, less-noticed consequence of charging base-period employers undercuts experience rating. If the separating employer is not a base-period employer as defined under state law, that employer effectively gets a "free" layoff. This gap in benefit charging was first identified in a study by Paul Burgess and Stewart Low using UI administrative data from Illinois. They found that more than a quarter of layoffs fell within the period between the end of the base period and the filing of the claim, effectively relieving the employer involved from benefit charging. Paul Burgess and Stewart Low, "Unemployment Insurance and Employer Layoffs." UI Occasional Paper 93-1 (U.S. Department of Labor, 1993).

About the National Employment Law Project

The National Employment Law Project is a non-partisan, not-for-profit organization that conducts research and advocates on issues affecting low-wage and unemployed workers. For more than 40 years, NELP has sought to ensure that work is an anchor of economic security and a ladder of economic opportunity for working families across America. In partnership with grassroots and national allies, NELP promotes policies to create good jobs, enforce hard-won workplace rights, and help unemployed workers regain their economic footing. For more about NELP, please visit www.nelp.org.

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