Center for American Progress

Toward a Strong Unemployment Insurance System

The Case for an Expanded Federal Role

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This social security measure gives at least some protection to thirty millions of our citizens who will reap direct benefits through unemployment compensation, through old-age pensions and through increased services for the protection of children and the prevention of ill health.

… This law, too, represents a cornerstone in a structure which is being built but is by no means complete. It is a structure intended to lessen the force of possible future depressions. It will act as a protection to future Administrations against the necessity of going deeply into debt to furnish relief to the needy. The law will flatten out the peaks and valleys of deflation and of inflation. It is, in short, a law that will take care of human needs and at the same time provide the United States an economic structure of vastly greater soundness.

– President Franklin D. Roosevelt, upon signing the Social Security Act that created the unemployment insurance system. August 14, 1935[1]

Introduction

The purpose of the unemployment insurance system, as President Franklin D. Roosevelt noted upon signing the legislation into law, is both to alleviate hardships for the unemployed and to counter recessions. The rules are that to receive unemployment benefits, a worker must have lost their job through no fault of their own and be actively seeking re-employment. In the wake of the Great Recession, the unemployment insurance system has been effective in helping families hardest hit by unemployment. In 2009 alone, unemployment benefits lifted 3.3 million families out of poverty.[2]

The second purpose of the unemployment insurance system affects us all, whether we are unemployed or not. The system is explicitly designed to act as an "automatic stabilizer" for the economy.[3] The unemployment insurance system acts "countercyclically," pumping money into the economy when unemployment is high by paying benefits that replace lost wages to those involuntarily unemployed while they search for work. This boosts economic growth just when the economy needs it most. Economists estimate that during the Great Recession, unemployment benefits closed about one-fifth of the recession-caused gap in total economic output.[4] These benefits are paid for through federal and state taxes on employers, which are highest when employment is high and thus not inordinately pulling down employment during recessions.

In the wake of the worst recession since the Great Depression, however, our nation's unemployment insurance system is in a crisis that threatens both its hardship-alleviating and automatic stabilizer functions. Most state unemployment insurance systems are now insolvent due to the lack of adequate payments into the system in the nonrecession years preceding the Great Recession and the subsequent tepid jobs recovery that has required many states to continue to pay benefits for an extended period of time. As a result, most states (32) have taken out loans from the federal government for their unemployment trust funds to the tune of over $42 billion (see Table 1).

This issue brief lays out the key elements of a plan to accomplish the goal of shoring up the unemployment insurance system's role as an effective automatic stabilizer, while addressing the solvency crisis in the states. The first step is to clear the deck by forgiving the trust loans of insolvent states and rewarding states that maintained positive trust-fund balances. We propose a set of conditions for the deck clearing that will improve the core functions of the unemployment insurance system by:

- Clearly delineating and separating the federal and state roles by increasing the role of the federal trust fund during times of high unemployment
- Reducing the wide disparity in eligibility rules and benefits across states

Our proposal will reduce costs for states as their labor markets struggle to emerge from the Great Recession, improve benefits for the unemployed, and better stabilize our economy in future recessions.

Addressing the trust-fund solvency issue is both urgent and important because if it is left unaddressed, states will see higher taxes long before the labor market has recovered from the Great Recession. Higher taxes will happen through two separate mechanisms. First, federal law requires that states with loan balances see a reduction in their federal unemployment insurance tax (the so-called FUTA tax) credit, which has the effect of increasing taxes on employers in states that have not repaid their trust fund loans quickly enough.[5] Three states—Indiana, Michigan, and South Carolina—currently fall under this rule and are paying higher taxes, and 25 states and the Virgin Islands are projected to experience a reduction in their FUTA credit next year (see Table 1).

TABLE 1

Outstanding loans from the Federal Unemployment Account

Data as of February 3, 2011

Federal Loans to StateTrust Funds	Current Balance as of 3 February 2011	Interest payments (1)	Total Loan Balance as a Share of State Budget (2)	Projected FUTA Credit reduction CY 2011 (%)	FUTA in terms of dollars, per employee in 2010	FUTA in terms of dollars, per employee in 2011
Alabama	$230,150,078.41	$9,206,003.14	0.87%	0.3	$57	$78
Arizona	$273,220,462.79	$10,928,818.51	0.87%	0.3	$57	$78
Arkansas	$330,853,383.31	$13,234,135.33	2.05%	0.3	$57	$78
California	$9,903,858,334.30	$396,154,333.37	3.89%	0.3	$57	$78
Colorado	$499,921,351.47	$19,996,854.06	2.01%	0.3	$57	$78
Connecticut	$624,872,034.48	$24,994,881.38	2.43%	0.3	$57	$78
Delaware	$42,995,867.88	$1,719,834.72	0.58%	0.3	$57	$78
Florida	$2,072,200,000.00	$82,888,000.00	2.74%	0.3	$57	$78
Georgia	$623,500,000.00	$24,940,000.00	1.50%	0.3	$57	$78
Hawaii	$22,137,527.06	$885,501.08	0.20%	0.0	$57	$57
Idaho	$202,401,700.22	$8,096,068.01	2.46%	0.3	$57	$78
Illinois	$2,622,351,981.66	$104,894,079.27	3.83%	0.3	$57	$78
Indiana	$2,038,274,462.02	$81,530,978.48	6.23%	0.6	$78	$99
Kansas	$100,713,006.68	$4,028,520.27	0.64%	0.0	$57	$57
Kentucky	$856,200,000.00	$34,248,000.00	3.19%	0.3	$57	$78
Massachusetts	$20,431,289.52	$817,251.58	0.04%	0.0	$57	$57
Michigan	$3,730,258,542.37	$149,210,341.69	6.30%	0.9	$99	$120
Minnesota	$550,422,527.45	$22,016,901.10	1.52%	0.3	$57	$78
Missouri	$789,012,013.67	$31,560,480.55	2.75%	0.3	$57	$78
Nevada	$675,287,952.36	$27,011,518.09	5.60%	0.3	$57	$78
New Jersey	$1,575,421,426.69	$63,016,857.07	2.54%	0.3	$57	$78
New York	$3,289,374,079.24	$131,574,963.17	2.01%	0.3	$57	$78
North Carolina	$2,573,801,312.79	$102,952,052.51	5.30%	0.3	$57	$78
Ohio	$2,364,536,031.00	$94,581,441.24	3.30%	0.0	$57	$57
Pennsylvania	$3,292,517,352.10	$131,700,694.08	4.24%	0.3	$57	$78
Rhode Island	$225,472,937.00	$9,018,917.48	3.07%	0.0	$57	$57
South Carolina	$933,209,451.49	$37,328,378.06	3.26%	0.6	$78	$99
Vermont	$50,191,494.07	$2,007,659.76	0.92%	0.3	$57	$78
Virgin Islands	$18,384,725.48	$735,389.02	2.20%	0.3	$57	$78
Virginia	$398,768,000.00	$15,950,720.00	0.95%	0.0	$57	$57
Wisconsin	$1,455,425,549.71	$58,217,021.99	4.08%	0.3	$57	$78
Total	$42,386,164,875.22	$1,695,446,595.01				

1. Assuming 4 percent interest rate and balance remains unchanged until September 30, 2011.

Note: If South Dakota receives a loan before January 1 they will face a FUTA reduction of 0.3 percent.

2. Calculation based off most recent (FY 2009) budget data for state governments collected by Bureau of the Census. See: http://www.census.gov/govs/state/.

Second, while the federal government waived interest accrual and payments on trust-fund loans between February 2009 and December 2010, this waiver has expired. As of October 2011, 32 states will owe an estimated $1.7 billion in interest (see Table 1). Yet the funds used to pay off the interest on the trust fund loans cannot come from the state taxes dedicated to funding the unemployment insurance system, but rather must come from either the states' general revenues or from other funding sources, and most typically come from charging a surcharge tax on current employers' payrolls.[6]

How policymakers address the unemployment insurance trust fund insolvency crisis will have significant implications for the effectiveness of the program as an automatic stabilizer in the years to come. To be an effective automatic macroeconomic stabilizer, the unemployment insurance system must replace a reasonable share of unemployed workers' lost income for a significant share of workers still looking for a job. It must also have the flexibility to extend the number of weeks of benefits available to the unemployed as the unemployment rate rises and job searches become protracted. Any reforms that address insolvency should protect—and improve—these core functions.

Both elements of the automatic stabilizer function are threatened by the debt piling up in most states' unemployment insurance trust funds. If history is any guide, as states struggle to pay off the debt, they will be under pressure to tighten eligibility rules and/or cut unemployment benefits, both of which limit the countercyclical effectiveness of the unemployment insurance system for our economy moving forward and punish workers who can't find jobs not for lack of trying. The last time states tightened eligibility criteria occurred after the U.S. economy faced double-digit unemployment in the early 1980s. Similar to what happened during the Great Recession, most states (32) took out federal loans to pay out benefits and the federal government did not provide assistance with the loans. Between 1981 and 1987, as states struggled with repayment, nearly all states (44) enacted more restrictive benefit eligibility standards and as a result, the percent of jobless workers receiving unemployment benefits dropped from 50 percent in 1975 to 31.2 percent in 1988.[7]

The problems facing the unemployment insurance system present Congress and the Obama administration with a unique opportunity not only to respond to the immediate problem of high-unemployment but also to create a stronger and more effective countercyclical unemployment insurance system going forward. The unemployment insurance system would be improved if the roles of the state and federal governments were harmonized so that the states could focus on what they do best—administration and re-employment services—and leave the financing for times when the unemployment rate is elevated to the federal government.

Unemployment insurance should act as an automatic stabilizer

The unemployment insurance system helps those who have lost their job for no fault of their own, but is also of great value to the economy as a whole. By providing benefits to those directly experiencing unemployment, unemployment insurance acts as an automatic stabilizer, filling in the gap in overall consumption left by high unemployment.

Families that receive unemployment insurance benefits typically spend these benefits rather than save them. To put some back of the envelope numbers on this, think of it this way: The typical worker brings home about $40,000 annually and about 15 million people are out of work, so without unemployment benefits, our national income would shrink by about $600 billion.[8] It's that gap that unemployment insurance fills and why it's critical to sustaining the economic recovery. And, why we can't just fill the output gap with tax cuts. In a report for the Department of Labor, Wayne Vroman, economist at the Urban Institute, estimated that the unemployment insurance system closed about one-fifth (18.3 percent) of the shortfall in the nation's gross domestic product during the Great Recession.[9]

Because unemployment benefits typically get spent immediately, unemployment insurance has what economists term a high "multiplier effect," because most every dollar that goes out in unemployment benefits is spent immediately, boosting economic growth.[10] Recent data from the Department of Labor shows that for every dollar of unemployment benefits provided during the Great Recession, $2 was added to U.S. gross domestic product, or the total output of goods and services in our economy.[11]

For the unemployment insurance system to be an effective automatic stabilizer, the system must provide benefits with a reasonable wage replacement to those who have lost their jobs through no fault of their own and who continue to seek employment without success. If the eligibility rules are too onerous and too few unemployed workers qualify for benefits, or conversely if benefit levels are too low relative to pre-job loss earnings, this will significantly dampen the overall countercyclical impact of the program.

The system must provide benefits with a reasonable wage replacement to those who have lost their jobs through no fault of their own and who continue to seek employment without success.

The unemployment insurance system, however, is not entirely successful at either reasonable wage replacement or covering everyone who is involuntarily unemployed. The Department of Labor reports that the typical worker only has about one-third of their pre-job loss wages covered by their unemployment benefits, although workers may receive more as generally benefits are capped at a 50 percent replacement rate[12] (see Box).

Just as importantly, there are wide differences in benefit levels across states and across workers, which limits the automatic stabilizing impact of unemployment insurance system. For instance, Wayne Vroman of the Urban Institute examines the effect of the wide differences in unemployment benefit recipiency across states on the economic stabilizing effect of unemployment benefits. He compares the effect on stability of the 10 states with the highest recipiency rates to the 10 states with the lowest and finds that the high-low differential in stabilizing effects was 1.5 to 1. That is, states with high recipiency rates were 50 percent more effective than low recipiency states in stabilizing their economies through unemployment benefits[13] (see Box).

To be an effective automatic stabilizer, the unemployment insurance system must also be flexible enough to extend the weeks of benefits as unemployment rises and job searches become longer. In a relatively good economy, a laid-off worker will be likely to find a new job in a relatively short period of time. In a bad economy, by contrast, as the number of unemployed workers rises and jobs are scarce, it obviously can take

Unemployment insurance eligibility and benefits vary widely across states

Federal laws and regulations provide broad guidelines to the states on their unemployment insurance systems in terms of who the program covers, who is eligible for benefits, and the level of benefits. Typically, eligibility is based on meeting earnings and hours thresholds over the year prior to losing a job involuntarily.[14] There is wide variation across states in eligibility, which leads to large differences in how many workers in a state receive unemployment benefits[15] (see Figure 1).

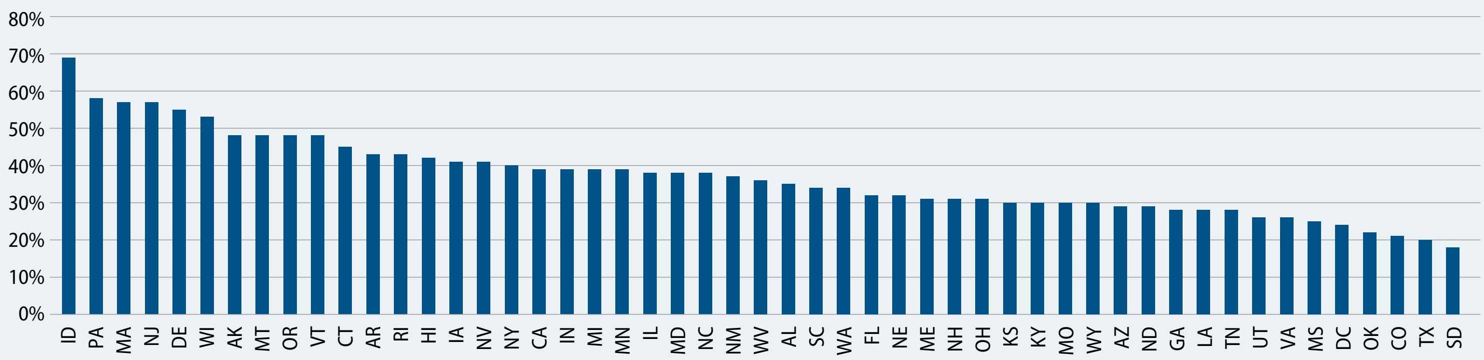
There are also wide differences in the level of benefits across states. Some of this is because of differences in local labor markets as states with lower median wages will have lower benefits. But, even beyond this, there is wide variation in benefits across states. Figure 2 shows a scatter plot of median wages and average weekly benefit amounts. While the relationship is upward sloping, the correlation between median wages and average weekly benefits is fairly small, indicating that there is wide variation that is not tied to local earnings.

to include their recent earnings to qualify for unemployment benefits. Earnings from the current quarter—the calendar quarter that the worker filed for unemployment benefits—had often been excluded in earnings calculations when states make eligibility determinations. To receive additional federal funds, states must provide benefits to workers in at least two of the following four categories:

- Part-time workers previously denied benefits because they were seeking part-time and not full-time work
- Individuals who have had to leave work for compelling family reasons
- Individuals with dependent family members who would qualify for $15 or more in weekly benefits per dependent to partially cover the costs associated with caring for that dependent
- Permanently unemployed individuals who need access to qualifying training programs to update their skills[19]

FIGURE 1

Unemployment benefits recepiency rate by state



Source: Department of Labor, Office of Unemployment Insurance

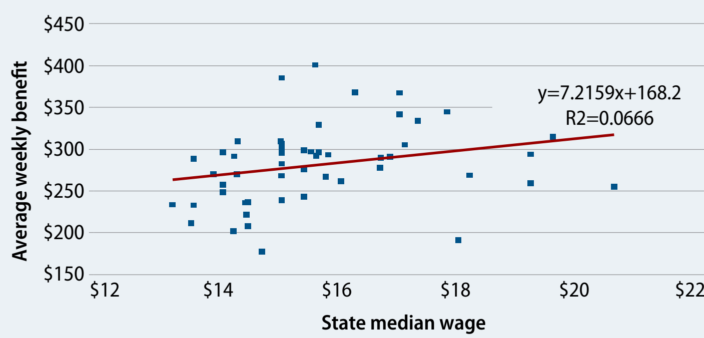
The differences in eligibility criteria across state are one of the reasons for wide disparities in receipt of unemployment benefits by race and ethnicity. According to the Kirwan Institute, for example, among those unemployed, African Americans and Latinos are 25 percent less likely than whites to receive unemployment benefits.[16] In 2009, African Americans were underrepresented among unemployment insurance recipients in 10 out of 21 states and Latinos were underrepresented relative to their share of the unemployed in 14 out of 18 states.[17] The disparity is largely due to the disproportionate representation of workers of color among part-time, low-wage, and seasonal workers.[18] These workers are much more likely to be ineligible for benefits and are less likely, even if eligible, to apply for benefits than high-wage and full-time workers.

In part to address these inequalities, the American Recovery and Reinvestment Act of 2009 included $7 billion in incentives for states to modernize eligibility by reducing restrictions. In order to receive the federal incentive dollars, states had to adopt an "alternative base period" that allows workers

As of September 2010, 32 states had taken up the federal funding and modernized their unemployment insurance systems. The remaining 18 states have until August 2011 to enact reforms and receive the federal incentive monies.[20]

FIGURE 2

Correlation between state median wage and average weekly benefits



more time to find a new job. Case in point: In the middle of 2007, when unemployment was 4.4 percent, the number of job seekers to job openings was 1.3, whereas now, with unemployment at 9 percent, that ratio is 4.8 to 1.[21]

Ordinarily, the unemployment insurance system provides 26 weeks of benefits. In times of high unemployment, when job searches can take much longer than 26 weeks, there are at present two programs that provide extra weeks of benefits, the Extended Benefits, or EB, program, and the Emergency Unemployment Compensation, or EUC, program (see Appendix on page 13 for more details on each program):

- The Extended Benefits program is a permanent program run by the states that is supposed to calibrate the weeks of benefits to labor-market conditions automatically by increasing the number of weeks of unemployment insurance benefits available to the long-term unemployed. It allows workers to receive up to 20 additional weeks of benefits after their original benefits expire, so long as they diligently look for a job but have no success, and their state has "triggered on" to the program. The program is supposed to trigger on when labor market conditions deteriorate and trigger off when they improve.[22]

- The Emergency Unemployment Compensation program is a fully federally funded program that Congress has implemented on an ad hoc basis. The most recent extension of EUC occurred on December 16, 2010, which extended unemployment benefits an additional 13 months until January 3, 2012.[23]

The unemployment insurance system must also be flexible enough to extend the weeks of benefits as unemployment rises and job searches become longer.

Problem is, as currently structured, the EB program really doesn't work.[24] During the Great Recession, the share of funds being paid out through extended benefits has been very small relative to the EUC program. The basic problems are the triggers don't work effectively and the funding scheme does not provide clear incentives to the states to use the program. Further, the EB program, as structured, provides insufficient tiers of extra weeks of unemployment benefits to deal with high unemployment recessions.

The triggers at which the EB program kicks in are set too high, which prevents many states from activating the program when unemployment begins to rise and states cycle off the program too early in the recovery because the triggers require ever-increasing unemployment rates in order to remain on. What's more, the EB program ordinarily is funded 50-50 between states and the federal government, which creates an important incentive to not use the EB program, but wait for fully federally funded assistance through the congressionally-implemented EUC program.[25] From the state's perspective, this makes sense: The federal government has the ability to fund the extra benefits, but this means that the unemployed are then waiting on federal action. During the Great Recession, Congress has allowed benefits to lapse twice, leaving families in the lurch even as unemployment hovered above 12 percent in some states.[26]

Congress dealt with states' ambivalence about the EB program in the American Recovery and Reinvestment Act of 2009 by fully funding states' EB programs if they adopted triggers that turned on quicker. But of the 38 states that provide EB, all but 11 states made the provision of EB dependent on full federal funding of the program.[27] This means that when the most recent extension of EUC and the full federal funding of EB expire on January 4, 2012, so will the EB program in most states that provide it.[28]

Finally, for the unemployment insurance system to be an effective automatic stabilizer, it must be adequately funded within a financing system that works. The system is designed to be a "forward-funded" system, meaning in good times there are more workers employed and tax revenues rise, with these revenues building up a trust fund to pay out benefits when unemployment rises. Most states, however, were not adequately forward funding their systems before the most recent recession, which, in any case, was deeper and more protracted than anyone had planned for.

For the unemployment insurance system to be an effective automatic stabilizer, it must be adequately funded within a financing system that works.

At the end of 2007, before the Great Recession began, most states (33) had less than a year's worth of reserves in their trust funds.[29] The Great Recession lasted until July 2009, and in most states, the labor market is not yet recovered. As a result of a lack of adequate forward funding, most of the state unemployment insurance trust funds are insolvent and states have had no choice but to take out loans from the federal government. As of February 3, 2011, 31 states and the Virgin Islands had insolvent trust funds and owed $42.3 billion to the federal government[30] (see Table 1). The U.S. Department of Labor estimates that by fiscal year 2013 the amount of outstanding loans could grow to over $65 billion.[31] The loans balances are significant, ranging from around one percent to over six percent of state's total budgets.

Under federal law, these funds must be paid back, often sooner than makes sense given economic conditions. There are two mechanisms at work. First, on November 10, 2010, three states saw a reduction in their state tax credit in the net FUTA calculation, which means that employers in those states saw an increase in net FUTA taxes[32] (see Table 1). By 2012, the Department of Labor estimates that states will have to increase taxes on employers by nearly $2 billion.[33]

Second, beginning October 1, 2011, states with loans have to begin paying the interest on their loans. Law also dictates that, while principal payments can be made with State Unemployment Tax Act tax revenue, interest payments cannot. States must make payments on interest through either general revenues or some other financing scheme.[34] Texas, for example, has dealt with this problem by floating bonds to pay off their trust fund debt.[35]

If history is any guide, the need to pay the loans on state trust funds will lead many states to act in ways that will aggravate, rather than ameliorate, the business cycle. A survey conducted by the National Association of Workforce Agencies found that state unemployment insurance taxes were expected to increase in 35 states for 2010 in order to address these trust fund solvency issues.[36] States currently have little leeway to change benefits. The American Recovery and Reinvestment Act of 2009 had a "non-reduction" rule, which meant that any state that accepted the additional $25 in weekly unemployment benefits per employee in their state would not be able to reduce their benefit levels. This rule was reattached to the EUC program when it was extended in December 2010. Once the EUC program fades, which in many cases coincides with states paying off their loan principal, states will again be at liberty to make changes to their benefit levels.[37]

It is all too likely that states with large loans will find it nearly impossible to pay down these loans, provide continuing benefits, and sufficiently capitalize their trust funds before the next rough patch hits. Most states will go into the next recession with even less reserves than what they had going into the Great Recession. Even if the economy moves to lower levels of unemployment by 2015 and the next period of high unemployment does not arrive for another five years, the structure of the unemployment insurance financing system makes it likely that state UI trust funds will still be undercapitalized. Doing nothing is not an option.

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The proposal

Fixing the unemployment insurance system is neither easy nor simple. Our proposal aims to outline a broad framework to address the current challenges and lay the foundation for long-term stability and effectiveness of the system overall. As they say, however, the devil is in the details and along those lines we acknowledge that our proposal is a first step in a longer process of policy articulation. Furthermore, we propose that this plan be implemented in reasonable stages as the labor market recovers from the Great Recession.

In thinking through the options available, policymakers should keep the program's goal of stabilizing and fueling the economy at the forefront of their thinking. Right now, we need to continue to spur economic demand and unemployment benefits remain our most potent tool to do that. Policy options should be evaluated with an eye to the long-term viability of the unemployment insurance system and should also ensure that until the unemployment rate comes back down, the system can effectively continue to serve as an automatic stabilizer, putting money in people's pockets when they need it most. The criteria for inclusion in the proposal are:

- Ensure that the system provides benefits with a reasonable wage replacement to those who have lost their jobs through no fault of their own and who continue to seek employment without success
- Ensure that the system is flexible enough to extend the weeks of benefits as unemployment rises and job searches become longer
- Ensure that the system is adequately funded within a financing system that works

We propose that the way to do this is to begin by clearing the slate of the debt currently on the books of states while rewarding states with positive balances. As a condition of benefitting from this clearing of the slate, we propose that policymakers clearly delineate and separate the federal and state roles in our nation's unemployment insurance system moving forward by increasing the role of the federal trust fund during times of high unemployment and by improving the wide disparity in eligibility rules and benefits across states.

Clearly, on its own, forgiving these trust-fund loans would create moral hazard problems as states will get the message that if they do not forward fund their programs, the federal government will intervene during the downturns. This is why we put clear conditions on debt forgiveness that focus on improving the program's core functions, while also rewarding the states that are not in arrears. Forgiving the loans without sufficient conditions is not an acceptable option as it would, among other things, make it much harder moving forward for states to convince the employers that forward funding their unemployment trust fund is a worthwhile endeavor.

The first condition for clearing the slate is that, moving forward, the states should be responsible for financing unemployment insurance benefits only when their state's economy is not experiencing elevated and prolonged unemployment.[38] States would trigger on to the program when their unemployment rate was elevated and the flow of funds into their system could not keep their trust fund solvent. To fund regular unemployment benefits during times when the unemployment rate is not elevated, states would continue to take in taxes under the State Unemployment Tax Act. Further, states would continue to administer their unemployment insurance programs and continue to have some, but not as much latitude in setting coverage, eligibility, and benefits.

A potential mechanism to ensure that states have the incentive to fund their portion of the program would be to link the state unemployment tax rate to the state's trust fund reserve levels. That is, once a state trust fund's reserves drop below a level sufficient to provide benefits at high rates for six months—an "average high cost multiple" of 0.5—the federal tax rate in that state would be automatically increased to maintain the trust fund. If trust fund reserves were above this level, incoming tax revenue would be diverted to the federal account. Thus, during periods of high unemployment, funds from this federal account would recapitalize state trust funds whose reserves had dropped below this requisite level. The power of this mechanism is that it builds adequate reserves during expansions, which could allow for automatic tax rate cuts during recessions, thus, adding an economic stimulus for firms and workers.

The federal government, through the already-established Federal Unemployment Tax Act of 1939, would finance unemployment benefits when unemployment was elevated and extra weeks of benefits for the long-term unemployed. Ideally, the federal government would broaden the federal base to match the Social Security wage base, which means policymakers can lower the tax rate currently in place for the Federal Unemployment

Tax Act. This proposal would accentuate the insurance principals of the overall system because it would do more to spread the risk of high unemployment across the states and it would lower taxes for businesses with low-wage workers relative to the current status quo. It will also require rethinking how the federal government sets the base for the state unemployment taxes, which are currently aligned with the federal base.

The federal government already is playing a large role in the unemployment insurance system. Not only do the states owe more than $42 billion in loans, but since November 2009, most of the funds being distributed through the unemployment insurance system are federal dollars, not including the funds being loaned to the state systems to pay out regular benefits (see Figure 3). Since the federal government is now picking up the tab for benefits when the unemployment rate is high, the overall structure of the unemployment insurance system should incorporate this fact into the financing arrangements for the system.

The change in financing should be coupled with ensuring that the EB system is fully functional and that it is structured to respond to even deep recessions. There is already broad agreement that the automatic triggers in the EB system need to be fixed[39] and President Obama's fiscal year 2010 budget included $21 billion over 10 years to fix these triggers, but did not lay out a specific plan.[40] The Center for American Progress has laid out a plan to fix the EB system, the basic elements of which are to turn the trigger for EB benefits on when a state's unemployment rate rises to an average of 6.5 percent or more over a three-month period or when the number of people claiming unemployment insurance rises by 20 percent or more, with subsequent tiers of more weeks of benefits for the long-term unemployed that trigger on as labor market conditions worsen and trigger off as conditions improve. In our proposal, the "look back" period to turn the program off is fixed from the time the program triggered on.[41]

The second condition is that in exchange for debt forgiveness and the federal government taking on the responsibility for benefits during periods of high unemployment, states would have to submit to greater harmonization of their eligibility and benefit levels. Our vision is that states would continue to have some discretion, just within a smaller band or a high floor or both, and that this would be a harmonization upwards, not downwards, especially with respect to eligibility criteria. Benefits should be set in terms of replacement rates, rather than levels, to be connected to local labor market conditions.

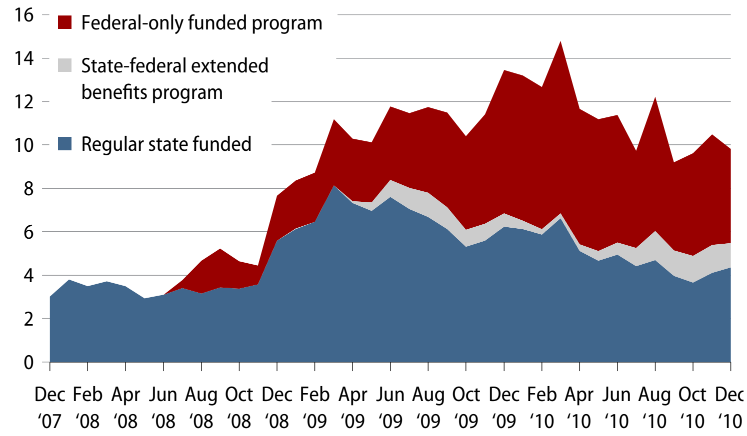
The high inequities in the unemployment insurance system across states cannot be maintained with federal dollars, nor do they promote the automatic stabilizer functions of the unemployment insurance system. Since one goal is to improve recipiency, this will have the added advantage of improving the overall automatic stabilizer function of the system.

Finally, it is essential that those states that provided adequate benefit levels and sufficiently forward-funded their unemployment insurance trust funds be rewarded for doing so. For this reason, we propose to allow those that have surpluses in their trust funds to keep the surplus funds for other uses. Policymakers will likely put some constraints on the use of these funds, but we leave that decision to a future iteration of this proposal. However, many of the solvent states voluntarily raised their SUTA taxes and put themselves at a competitive disadvantage to those states that chose to cut their own SUTA taxes and reduce benefits. For that reason, policymakers should strive to structure the plan to reward states that not only have solvent trust funds, but also meet certain benefits and eligibility requirements.

FIGURE 3

The growing federal role in providing unemployment benefits

Total unemployment insurance benefits paid by month and type of program



Source: Employment and Training Administration.

Who wins in this proposal?

We all benefit from an unemployment insurance system that can be an effective automatic stabilizer during recessions, especially prolonged recessions like the one we're now escaping. We have seen how important this program has been during the Great Recession, not only alleviating hardships, but boosting the economy overall. From the federal perspective, a better-functioning unemployment insurance system will be a much-improved tool for macroeconomic stability.

States also benefit from this proposal as the ongoing difficulty of financing their unemployment insurance trust funds for recessionary periods is eliminated and the burdensome cost of making interest and principal payments on the trust fund loans is eliminated. Those states that have been solvent will see an immediate increase in funds available for other purposes, as trust fund surpluses can be reallocated to other purposes.

Employers will not have to bear potentially escalating tax increases to pay for loans to the federal government. While our proposal calls for an increase in the amount of wages subject to federal unemployment taxes under the Federal Unemployment Tax Act, it should still save employers money compared to what would happen if our proposal were not implemented as they will not have to pay back extremely onerous current debts.

By providing a more stable financing system for unemployment insurance, employees can be assured that their benefits will be available at times of crisis. This will benefit not only those that experience unemployment but will help boost the economy overall and dampen the depth of future recessions for everyone.

Appendix

Existing programs that provide extended unemployment benefits

In addition to the regular state run unemployment insurance program, there are also two additional programs that provide benefits during periods of heightened unemployment: the Extended Benefits program and the Emergency Unemployment Compensation program.

Extended Benefits

Extended Benefits is a permanently authorized program that was created in 1970 by the "Federal-State Extended Unemployment Compensation Act of 1970."[42] This program provides benefits *on top of* the regular 26 weeks of unemployment benefits. Ordinarily, this program is funded 50-50 between states and the federal government, and is available to states that meet economic conditions as specified in the law.[43] A state can "trigger on" EB when its insured unemployment rate, the percentage of the labor force receiving UI benefits, has equaled or exceeded 5 percent for the preceding 12 weeks and is rising.[44] The 1970 legislation also allows states an optional trigger for between 13 and 20 weeks of EB based on the state's total unemployment rate, or TUR, in the following two ways:

- 13 weeks for states whose three-month average TUR equals or exceeds 6.5 percent and has a TUR that is 110 percent above the TUR of either of the previous two years[45]
- 20 weeks for states whose three-month average TUR equals or exceeds 8 percent and has a TUR that is 120 percent above the TUR of either of the previous two years[46]

The American Recovery and Reinvestment Act of 2009 included a provision that provided full federal funding of EB for all states that chose to use this optional TUR-based trigger.[47] Twenty-seven states passed legislation that put in the place the optional trigger, but tied their EB program to full federal funding. When Congress allowed extended unemployment benefits to lapse, these states' EB programs turned off as well. The 11 other states that provide EB did not tie their program to full federal funding and their program continues regardless of federal funding.[48]

Emergency Unemployment Compensation

The Emergency Unemployment Compensation Program is an emergency benefits program provided by Congress and fully federally funded. This program is *on top of* the regular 26 weeks of benefits and the EB program.

Recent legislation has extended both the EUC program in its entirety and the payment of the states' portion of the full federal contribution to the EB program. The most recent extension occurred on July 22nd of last year with the passage of "The Emergency Unemployment Extension Act of 2010."[49] At present, individuals with balances remaining at their respective tier level are eligible to receive EUC benefits until the week ending December 31, 2011.

Currently, the EUC program provides benefits for 34 weeks to 53 weeks, depending on the unemployment rate in the state, and includes four separate tiers of benefits:

- Tier 1: (20 weeks): Available to all states
- Tier 2: (14 weeks): Available to all states
- Tier 3: (13 weeks): Available to states with three-month average unemployment rates of 6 percent or higher
- Tier 4 (6 weeks): Available to states with a three-month average unemployment rate of 8.5 percent or higher

Endnotes

1 Social Security Administration. "FDR's Statements on Social Security" (2011), available at http://www.ssa.gov/history/fdrstmts.html#signing.

2 Heather Boushey and others, "What the Census Tells Us About the Great Recession: New Data Reveals Decreased Income and Health Coverage" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/09/joint_poverty_memo.html. One reason for the effectiveness of bringing people out of poverty was that the Recovery Act included a federal additional compensation benefit of $25, which has distributed nearly $14 billion in additional funding to households since the Recovery Act was enacted. During 2010 alone, it has delivered over $1.1 billion, on average, per month to the states. See: Heather Boushey, Christine Riordan, and Luke Reidenbach, "Today's Unemployment Crisis by the Numbers" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/06/ui_extensions.html.

3 Heather Boushey and Jordan Eizenga, "Extending Unemployment Insurance Benefits 101: UI Benefits Help Workers, Businesses, and the Economy" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/09/ui_benefits101.html.

4 Wayne Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession" (Washington: U.S. Department of Labor, 2010), available at http://wdr.doleta.gov/research/keyword.cfm?fuseaction=dsp_resultDetails&pub_id=2447&mp=y.

5 Specifically, federal taxes on employers rise for states with outstanding loans on November 10 following the second consecutive January 1 on which the state had an outstanding loan.

6 The principal may be paid from the SUTA system.

7 National Employment Law Project. "Understanding the Unemployment Trust Fund Crisis of 2010" (2010), available at http://www.nelp.org/page/-/UI/solvencyupdate2010.pdf?nocdn=1. However, Vroman found that eligibility for benefits has been restored, such that the unemployment benefit recipiency rate after 1996 was back to an average that is close to where it had been prior to 1981. See Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession."

8 Author's calculations from U.S. Census Bureau and Bureau of Labor Statistics.

9 Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession."

10 Boushey and Eizenga, "Extending Unemployment Insurance Benefits 101: UI Benefits Help Workers, Businesses, and the Economy."

11 Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession."

12 Although states differ in their rules, generally, benefits are capped at a 50 percent replace rate up to the average wage minus 68 percent. U.S. Department of Labor. For more information, see: Office of Unemployment Insurance, "Monetary Entitlement" (2010), available at http://ows.doleta.gov/unemploy/pdf/uilawcompar/2010/monetary.pdf.

13 There is not parity between disparities in recipiency and effect on macroeconomic stability as the ratio of stabilizing effect is lower than the ratio of recipiency across the two groups, which is 2 to 1. In Vroman's view, the explanation appears to be the stronger negative feedback of lagged unemployment in the high-recipiency states. See: Vroman, "The Role of Unemployment Insurance As an Automatic Stabilizer During a Recession."

14 Katelin P. Isaacs, Julie M. Whitaker, and Alison M. Shelton, "Unemployment Insurance: Available Unemployment Benefits and Legislative Activity" (Washington: Congressional Research Service, 2010), available at http://www.workforceatm.org/sections/pdf/2010/Unemployment%20Insurance%20Available%20Unemployment%20Benefits%20and%20Legislative%20Activity.pdf?CFID=636590&CFTOKEN=25616765.

15 National Employment Law Project, "State Reports and Statistics" (2010), available at http://www.nelp.org/index.php/site/issues/category/State_Reports_and_Statistics/.

16 Kirwan Institute for the Study of Race and Ethnicity, "Unemployment Insurance, the Recession, and Race: A Kirwan Background Report" (Columbus: Kirwan Institute, 2010), available at http://4909e99d35cada63e7f757471b7243be73e53e14.gripelements.com/publications/unemployment_insurance_the_recession_and_race_july_2010.pdf. It should be noted, however, that the unemployment insurance system does not track beneficiaries by race or ethnicity, so this data comes from surveys of households who report receiving benefits.

17 Andrew Grant-Thomas, "(Why) Are African Americans and Latinos Underrepresented Among UI Beneficiaries?" (Washington: National Association of Social Insurance Annual Conference, 2011).

18 Kirwan Institute for the Study of Race and Ethnicity, "Unemployment Insurance, the Recession, and Race: A Kirwan Background Report."

19 Andrew Stettner, "What is UI Modernization and Why is it Important?" (Washington: National Employment Law Project, 2008), available at http://nelp.3cdn.net/9a398fa5e086804cea_obm6yhsxp.pdf.

20 National Employment Law Project. "Recovery Act's Unemployment Insurance Modernization Incentives Produce Bipartisan State Reforms in Eight States in 2010." (Washington, DC: National Employment Law Project, September 3, 2010), available at: http://www.nelp.org/page/-/UI/2010/modernization.update.pdf?nocdn=1

21 Bureau of Labor Statistics. "Job Openings and Labor Turnover Survey." (Washington: U.S. Department of Labor, 2011), available at http://www.bls.gov/news.release/pdf/jolts.pdf

22 Julie M. Whitaker and Katelin P. Isaacs, "Extending Unemployment Compensation Benefits During Recessions" (Washington: Congressional Research Service, 2011).

23 Individuals who are receiving EUC as of January 3, 2012 will be grandfathered in. Individuals receiving EB as of January 4, 2012 will be grandfathered and the federal government will continue to pay 100 percent of their benefits. For the most up-to-date account of available unemployment benefits see: Isaacs, Whitaker, and Shelton, "Unemployment Insurance: Available Unemployment Benefits and Legislative Activity."

24 Jeffrey B. Wenger and Heather Boushey, "Triggers that Work: Redesigning an Effective Unemployment Insurance Extended Benefits Program" (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/02/pdf/ui_trigger.pdf.

25 Given that the costs associated with the Emergency Unemployment Compensation program are entirely covered by the federal government, states typically prefer this program to the Extended Benefits program whose cost is only half-covered by the federal government.

26 Bureau of Labor Statistics, "Current Population Survey" (2011), available at http://www.bls.gov/webapps/legacy/cpsatab1.htm.

27 Boushey, Riordan, and Reidenbach, "Today's Unemployment Crisis by the Numbers."

28 Isaacs, Whitaker, and Shelton, "Unemployment Insurance: Available Unemployment Benefits and Legislative Activity."

29 National Employment Law Project, "Understanding the Unemployment Trust Fund Crisis of 2010."

30 Office of Unemployment Insurance, "UI Budget: Trust Fund Loans" (2011), available at http://workforcesecurity.doleta.gov/unemploy/budget.asp#tfloans.

31 Office of Unemployment Insurance, "UI Outlook Overview" (2011), available at http://www.ows.doleta.gov/unemploy/content/prez_budget.asp.

32 Julie M. Whitaker, "The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States." (Washington: Congressional Research Service, 2010), available at http://workforceatm.net/sections/pdf/2011/TheUnemploymentTrustFundUTFStateInsolvencyandFederalLoanstoStates.pdf?CFID=636565&CFTOKEN=52743633.The Balanced Budget Act of 1997 gives states loans interest-free if they are fully repaid by September 30 of the same calendar year in which the loan was made. The American Recovery and Reinvestment Act of 2009 temporarily extended the interest free period on all loans from the federal government until December 31, 2010. Interest payments on outstanding debt will begin on January 1, 2011. Further, the Balanced Budget Act creates a penalty for having a loan outstanding on November 10 of the third calendar year in which the loan was made. All states that have unpaid loan balances after this date see their FUTA tax credit, which usually reduces the effective FUTA tax rate to 0.8 percent, reduced by 0.3 percent each year in which there is an outstanding balance. So if the loan is not repaid in full, then the FUTA tax rate will increase to a total of 1.1 percent. The Recovery Act included a provision that allowed states with total unemployment rates above 13.5 percent to be exempt from this requirement and to delay interest payments by up to 9 months, but this expired at the end of December 2010.

33 U.S. Department of Labor, "Program Statistics" (2011) available at http://workforcesecurity.doleta.gov/unemploy/finance.asp.

34 National Employment Law Project, "Understanding Payment of Interest on Federal Loans to State Unemployment Trust Funds" (2011), available at http://nelp.3cdn.net/2f0be3ad3bb06b5704_w1m6bnehw.pdf.

35 Amy Lane, "State Eyes Bonds to Pay UI Debt: Texas Sets Example; Biz Wants to Hear More" (Detroit: Crain's Detroit Business, 2011), available at http://www.crainsdetroit.com/article/20110206/SUB01/302069970/state-eyes-bonds-to-pay-ui-debt-texas-sets-example-biz-wants-to.

36 National Association for Workforce Agencies, "UI Trust Fund Solvency Survey, December 2009" (2009), available at http://www.workforceatm.org/sections/pdf/2009/NASWA%20Solvency%20Survey%20Summary%20of%20State%20Responses.pdf. For fiscal year 2011, the Department of Labor estimates that 24 states will see taxes increases simply through reductions in the FUTA credit alone. For more information, see: U.S. Department of Labor, "Program Statistics."

37 In the American Recovery and Reinvestment Act, that rule was attached to the FAC, but the non-reduction rule was reattached to the EUC benefit once FAC expired in the Unemployment Compensation Extension Act of 2010. See Isaacs, Whitaker, and Shelton, "Unemployment Insurance: Available Unemployment Benefits and Legislative Activity."

38 Clearly, the definition of "elevated unemployment" will be a key determinant of the effectiveness of this program. The elevated unemployment rate should probably be set for around 6 or 6.5 percent, consistent with the triggers in the Extended Benefits system and recommendations from the Advisory Council on Unemployment Compensation, see: U.S. Advisory Council on Unemployment Compensation, "Collected Findings and Recommendations, 1994-1996" (1996), available at http://research.upjohn.org/externalpapers/1.

39 Ibid.

40 Office of Management and Budget, "Budget of the United States Government: Browse Fiscal Year 2010" (2010), available at http://www.gpoaccess.gov/usbudget/fy10/browse.html.

41 Wenger and Boushey, "Triggers that Work: Redesigning an Effective Unemployment Insurance Extended Benefits Program."

42 Social Security Administraton, "Employment Security Amendments of 1970" (1970), available at http://www.ssa.gov/OP_Home/comp2/F091-373.html.

43 Whitaker and Isaacs, "Extending Unemployment Compensation Benefits During Recessions."

44 SSA, "Employment Security Amendments of 1970." Note: IUR or "insured unemployment rate" is the total number of unemployed individuals receiving benefits divided by the total number of individuals who are employed in jobs covered by unemployment compensation and subject to unemployment insurance taxes.

45 Ibid, Sec. 203(f)(1)(A).

46 Ibid, Sec. 202(b)(1)(3)(A)(B).

47 The optional trigger sets a lower threshold and therefore more people gain access to Extended Benefits, which was a goal of the ARRA. *American Recovery and Reinvestment Act of 2009*, H.R. 1, 111th Cong.. Sec. 2005, Subtitle A.

48 Boushey, Riordan, and Reidenbach, "Today's Unemployment Crisis by the Numbers."

49 *Unemployment Compensation Extension Act of 2010*, H.R.4213, Section 2, available at http://thomas.loc.gov/cgi-bin/query/D?c111:7:./temp/~c1112cDvkN.

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