

**Unemployment Insurance Primer:  
Understanding What's At Stake  
as Congress Reopens Stimulus Package Debate**

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With the economy in recession, President Bush is asking (has asked) Congress to reconsider the stimulus package tabled when members adjourned for the Christmas holidays. Senator Daschle has countered with a retooled democratic stimulus plan. Both contain proposals to strengthen the unemployment insurance (UI) system. As the debate intensifies it will be critical to understand the key issues—how the system works now, where it needs fixing, which workers are most affected, and how the system contributes to stimulating the economy. Below are answers to some of the questions at the heart of understanding the program and the potential impact of reforms under consideration.

*How urgent is reform of the system?*

Unemployment relief is important today as in past recessions. The share of unemployed individuals who receive benefits has declined over time and in some instances benefit levels as a percentage of wages also have declined. Reciprocity rates vary across the states, with some states reporting very low numbers of unemployed persons applying for and receiving UI benefits. At the same time, the length of average unemployment has increased, so that more jobless workers use up their benefits before they get new jobs. Many of these long-term unemployed fall into poverty.

*Which workers are most vulnerable and why?*

The low rate of UI reciprocity is particularly troublesome for the large numbers of workers with low earnings, i.e., low-wage, part-time and workers with intermittent work histories. Some of these workers were recently on welfare, but the 1996 reform measures forced many to work and the result was typically work in low-paid employment. In a recession, however, UI won't be available as a safety net for many with low wages, both former welfare recipients and others with low earnings. All states require a certain level

of earnings to qualify for UI benefits. Unless eligibility is expanded, we can anticipate low receipt of benefits among unemployed low-wage and part-time workers and workers with irregular work patterns, and especially among workers in the deep South, the Southwest and the Rocky Mountains.

Those who exhaust UI benefits also will need extended benefits. Unlike initial claims for unemployment benefits, which tend to lead the economy during downturns, long-term unemployment lags behind economic performance. As a consequence, payments for long-term unemployment also tend to lag during economic recoveries. This pattern can be anticipated in 2002-03 even with a mild recession.

*What's on the table for Congressional consideration?*

As in past recessions, Congress is considering extended benefits, perhaps of up to 13 weeks, for those who use up their maximum 26 weeks in regular benefits. Additionally, a series of innovative measures to help the unemployed have been offered, measures not considered in the past. These include:

- Changes in the way that eligibility is calculated in order to expand the numbers of low-wage and part-time workers who would qualify for and receive UI benefits. This would extend benefits to the kind of workers traditionally excluded from the program and probably will reduce the geographic variation among states.
- An increase in the level of weekly benefits unemployed persons receive.
- One-time grants to states from overflowing federal UI trust funds. States would be able to use this money to pay for added administrative expenses, to increase benefits, or for other ways that bolster the UI system.
- Helping unemployed workers pay for the health care costs, either by subsidizing the premium costs of their private insurance or by extending Medicaid for low-income workers.

Congress could pay for these new benefits with regular appropriations, with distributions from UI trust fund accounts, or with a combination of the two. Since spirited debate can be anticipated in the Congress during the upcoming months, it is important understand how UI works at present, trends in coverage and the fiscal situation of the UI

program. The latter involves financial considerations regarding monies controlled at both the state and federal levels of government

*What is the unemployment insurance program?*

Unemployment insurance pays temporary cash benefits to workers who have lost jobs through no fault of their own. Weekly benefits typically replace 50 percent to 60 percent of lost wages up to a ceiling. Maximum benefits vary by state, but most state maximums represent from 50 to 70 percent of statewide average weekly wages. Someone who becomes unemployed and files a claim is usually entitled to a maximum of 26 weeks of benefits over the next 52 weeks. The only way a worker can collect after those benefits are “exhausted” is to re-enter the workforce and earn enough to establish a future entitlement. During past recessions, the federal and state governments have extended the 26-week benefit period.

The federal and state governments act as partners in the UI system. States undertake most UI administrative activities related to both paying benefits and collecting from employers the payroll taxes that support the program. The individual states establish the requirements for benefit eligibility, e.g., the requirements for entry eligibility, weekly benefit amounts and potential benefit duration. For state UI taxes, employers pay at a tax rate based partly on their experiences in paying benefits to current and former workers. The Federal government is also an important partner in UI program administration, requiring the states to make prompt and accurate administrative decisions over eligibility, to satisfy certain statutory tax provisions (a maximum tax rate of at least 5.4 percent and an annual tax base per worker of at least \$7,000<sup>1</sup>) and to practice efficient financial management of contributions and benefit payments.

*What is the relationship between the economy and unemployment benefits?*

When unemployment rises, so do claims for unemployment insurance. In the third quarter of 2001, economic growth was negative after growth in real gross domestic product (GDP) of less than one percent in each of the two preceding quarters. Up to this

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<sup>1</sup> Strictly speaking, having a \$7,000 tax base is an inducement rather than a requirement. A state can have a tax base below \$7,000 per worker, but if it does all employers will be taxed at a uniform statutory rate of 5.4 percent rather than at current rates which have averaged close to 1.7 percent in recent years

point in time, January 2002, the downturn has been modest compared with earlier recessions, when growth fell sharply and quickly. Negative real growth of 6 percent or more occurred in a single quarter in 1958, 1975 and 1982.

As a result of the current economic downturn, the household labor force survey (Current Population Survey or CPS) shows that unemployment rose during 2001, particularly during the last half of the year, and reached 5.8 percent of the labor force in December. Claims for UI benefits increased along with the rise in the unemployment rate. Throughout 2001, the number of claims in each month was higher than the monthly claims a year earlier, with the gap growing throughout the year. During October-December 2001, the number of claims was 1.3-1.5 million higher than the number a year earlier. (See Chart 1)

Besides directly helping families pay their bills, UI acts as a stimulus to the economy, as it helps to maintain aggregate consumer spending. UI's macroeconomic stabilizing impact was a big reason the program was enacted during the Depression in the 1930s. The program acts automatically to counteract contractions in total production.

#### *How generous are the benefits?*

State programs vary in their generosity, which is measured by the ratio of average weekly benefits to average weekly wages. This measurement is known as the replacement rate. An analysis of national aggregates and averages since 1949 shows that benefit generosity has remained stable for a long period, ranging from a low in 1952 to a high in 1975. There was virtually no change between 1984 and 1994, when benefits averaged nearly 35 percent of the weekly wages of workers covered by the program. (See Chart 2). A modest decline in replacement rates occurred in the late 1990s, but the decrease in replacement depicted in Chart 2 is more related to rapid wage growth of high-wage workers than slow growth in weekly UI benefits.

#### *How high is recipiency?*

Over past decades the percentage of unemployed who actually receive jobless-related benefits has decreased. "Recipiency" refers to the ratio of the number of beneficiaries to the number of unemployed workers. Recipiency rates as depicted in

Chart 2 are measured two ways. Reciprocity 1 is the ratio of all beneficiaries to unemployment. Three groups of recipients are included in this ratio: those paid under the regular UI program plus recipients of the Federal-State Extended Benefits (EB), and temporary federal programs. The latter two programs operate during recessions. Reciprocity 2 is the ratio of regular UI program beneficiaries to unemployment. The regular UI program operates in all periods, and as noted, has maximum eligibility of 26 weeks during a given 52 week period. The vertical gap between Reciprocity 1 and Reciprocity 2 shows that EB and the temporary federal programs were important in past recessions.

There has been a strong long-run decline in reciprocity under the regular UI program since the late 1950s. In most years before 1960 Reciprocity 1 in Chart 2 exceeded 0.40 while it has fallen below 0.30 in most years since 1981. Since 1981 Reciprocity 1 has averaged 0.29. Changes in the economy and in the UI program have both contributed. The main reasons for the decline in UI reciprocity are discussed below.

Meanwhile, the role of the federal government in providing benefits to the long-term unemployed during recessions has grown. There were no extended-benefits programs during the recessions of 1949 and 1954, and only a modest federal infusion during the recessions of 1958 and 1961. Extended benefits got their biggest boost in the mid-1970s, but the long-term unemployed also received large payments during 1971-1972, 1980-1983 and 1991-1994. Since the early 1980s, the states have played a smaller role in providing benefits for the long-term unemployed.

*Do individuals usually find jobs before they exhaust their benefits?*

Over the past five decades, the average length of unemployment has gradually increased. According to data from the monthly household labor force (HLF) survey, joblessness averaged 15.7 weeks in the 1990s, compared with 11.3 weeks in the 1950s. However, the 26-week maximum time that benefits last has not changed much over time. That means a greater percentage of jobless individuals today exhaust their benefits before they get a new job: In the 1990s, the exhaustion rate was 36 percent compared with 25 percent in the 1950s. Even in 2000, when unemployment was low, 30 percent of UI

recipients exhausted their benefits. The long-term unemployed experience high poverty rates, so extended benefits are important in reducing hardship.

*Why has reciprocity declined?*

The nature of work and the composition of the workforce have evolved over the past 50 years. Three factors often cited as contributing to lower reciprocity are the decrease in the manufacturing share of employment, the decrease in unionization and increased prevalence of part-time work. There's also been a shift of population to states that typically have lower reciprocity. Over the long term states have imposed stricter eligibility conditions, excluding many workers with low earnings.

Workers with low wages, low hours worked and irregular work patterns typically have above-average unemployment rates.<sup>2</sup> They also have low rates of receipt of UI benefits. Prior to the onset of unemployment, most of these workers have demonstrated a substantial commitment to the world of work, and they will continue to seek paid employment in the future. During their unemployment spells, however, the vast majority do not collect UI benefits.

*How do states decide eligibility?*

State programs make eligibility decisions based on monetary and non-monetary factors. Many lower-wage workers are excluded for monetary reasons because of the way that states calculate eligible earnings. States look at earnings during a "base period" of employment before a claim is filed. However, this base period usually excludes earnings the last three to six months of employment. A dozen states have boosted the numbers of low-wage beneficiaries by including more recent earnings in their eligibility calculations.

Also, the circumstances surrounding a job separation are important in determining eligibility, e.g., people who quit jobs typically are not eligible for UI benefits. There are some exceptions. Some states make a distinction between job-related and personal reasons for leaving. In states where good personal reasons for leaving are recognized, receipt of benefits is more likely. For example, if a person in such a state quits to care for

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<sup>2</sup> U.S. General Accounting Office, "Unemployment Insurance, Role as Safety Net for Low-Wage Workers is Limited," Report GAO-01-181, (Washington, D.C.: U.S. General Accounting Office, December 2000).

a family member who is sick, he or she could be compensated under certain conditions. The conditions would include the following: 1) seeking and being granted a leave of absence, 2) attempting to resume work at a later time but the job is no longer available and 3) then filing for UI benefits. In states where only job related reasons for quitting are compensable this person could not collect UI benefits. In all states most UI recipients are persons who have lost jobs through employer actions, e.g., layoffs.

Most states require that the claimant be available for full-time work even if the jobless individual had been working less than 35 hours a week. Only a few states routinely permit those seeking part-time work to collect UI benefits.

*Do differing eligibility standards across the states contribute to low reciprocity?*

Eligibility rules differ widely across states, and that has led to big variations in the percentage of unemployed workers who receive UI benefits. During 1998-2000, workers in the 10 states with the highest percentage of beneficiaries (averaging 50 percent) were nearly three times more likely to collect UI benefits than workers in the 10 states with the lowest reciprocity (averaging 18 percent). Low-reciprocity states significantly pull down the national average. (See map).

Map 1 arranges the states into three groups according to reciprocity during 1998-2000. In high-reciprocity states, an average of 35 percent or more of unemployed workers received benefits, while in low-reciprocity states, less than 25 percent of unemployed workers received benefits. The high-reciprocity states are located mainly in the Northeast, the upper Midwest and the West Coast. Low reciprocity is concentrated in the Deep South, the Southwest and the Rocky Mountains. These patterns have persisted since the late 1960s, when state measurements were first available.

In low-reciprocity states, the percentage of newly jobless persons who apply for benefits falls below the national average.<sup>3</sup> Nationwide about half of newly unemployed individuals file for benefits, while in some low-reciprocity states the application rate is half that. Also, in states with low reciprocity, disputes over eligibility linked to job separations are more likely. In a few states, up to one-fifth of all applications are

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<sup>3</sup> This discussion draws from a recent project report to the U.S. Department of Labor: Wayne Vroman, "Low Benefit Reciprocity in State Unemployment Insurance Programs," The Urban Institute (June 2001).

challenged. Such challenges lead to fewer awards and discourage individuals from filing claims in the first place.<sup>4</sup>

*Is there enough money saved up to pay UI benefits during a recession?*

State and federal payroll taxes levied on employers support the UI programs. Fifty-three state accounts<sup>5</sup> pay benefits in the regular UI program and the state share of EB. There are three federal trust fund accounts each dedicated to specific activities: one that pays the administrative costs of UI programs and the Employment Service in the states; one that pays for the federal share (50 percent) of EB payments, and a third that makes loans to states with insolvent trust funds. At the end of September 2001, the combined balances across all trust funds exceeded \$90 billion—\$51.6 billion in the state accounts and \$38.6 billion in the federal accounts.

The three federal accounts are currently at statutory maximums. For the past decade, the federal government has taken in more UI taxes than it has returned to the states. These excess funds are slated for return to the states under so-called Reed Act distributions, a vehicle for returning monies to the states after the federal trust funds reach statutory thresholds. The current fiscal year is the first when substantial sums are to be returned to the states. Each state's share of the distribution will reflect its share of federal taxable UI wages.

Most state accounts which are dedicated to paying regular UI benefits and the state share of EB also have large balances. Though it's difficult to know how long the current economic downturn will last and how severe it will be, most states have enough money to pay benefits for a number of months. That would give them time to consider solvency legislation in their 2002 sessions if account balances are depleted. Only New York, North Dakota, and Texas have what's considered to be very low balances. If payouts were to occur at a rate equal to the average of the three highest payout years (of the past 20), these three states would have less than four months of reserves. They are likely to require loans in early 2002.

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<sup>4</sup> Short duration of UI benefits could also contribute to low recipiency, but while there is variation in duration it is less closely associated with low recipiency than low initial application rates.

<sup>5</sup> There are programs in fifty states plus the District of Columbia, Puerto Rico and the Virgin Islands.

Still, technical insolvency does not pose an immediate threat to claimants in insolvent states since the states can borrow from the federal trust fund dedicated to making loans to the states. During the recession in the early 1990s, seven states needed such loans but only Connecticut and Massachusetts had loans that could be described as large.<sup>6</sup>

As noted, states administer most of the day to day benefit payment and revenue collection activities of UI programs. The states share a widespread concern that monies allocated to them from the federal Employment Security Administration Account (ESAA) account are insufficient. ESAA funds returned to the states for UI and ES administration have been consistently less than the payroll taxes that support these administrative activities. In fiscal year 1999, for example, ESAA payroll taxes totaled \$5.4 billion while administrative allocations totaled \$3.2 billion.

Low ESAA funding levels have caused states to make several adjustments in UI and ES administration including resorting to appropriations from state revenue sources. Payroll taxes and general revenues are being used in several states to supplement monies from the ESAA allocations. In fiscal years 1999 and 2000 these state supplements totaled roughly \$250 million and \$300 million respectively.

A Reed Act distribution would initially make deposits into the state UI trust fund accounts. However these monies would be separately identified from other monies already in the state accounts. Most important, the Reed Act specifies that the use of the Reed Act monies is to be determined through state legislation. Unlike other monies in the state accounts, the use of these monies is not restricted to just paying UI benefits.

#### *How would the states use the Reed Act money?*

Under current law, the federal trust accounts will be making big distributions to the states. During the stimulus debate, the National Association of State Workforce Agencies (NASWA) asked all state employment security agencies to note how they would advise their governors and legislators to use the money.<sup>7</sup> The agency directors were asked about the advice they would give their governors on the use (or uses) of Reed

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<sup>6</sup> Total loans to these two states in the early 1990s exceeded 1 percent of (1990) covered payrolls.

<sup>7</sup> See National Association of State Workforce Agencies, "How Would Your State Use An Accelerated Reed Act Distribution" A Summary of A State Survey," November 2001

Act monies. Note the survey responses refer only to advice they would give and do not necessarily provide a blueprint of how the monies would actually be used in the states. The political processes in the states could yield quite different outcomes.

Unfortunately, many state agencies do not intend to increase UI benefits for the unemployed. Most states said the funds should be used to raise state trust fund balances, or to be used to avoid UI tax increases or benefit reductions. Only about one-third indicated they would consider benefit extensions targeted to unemployed persons who had exhausted their regular benefits. Only five would consider expanding their base period for purposes of including more low-wage workers. Just three were interested in expanding access to part-time workers. State agencies also said they were unlikely to use the new funds to increase weekly benefits. Most states indicated some of the funds would be used to improve UI administration.

Two final observations about the Reed Act distribution are important. 1) The Congress could specify how some or all of the Reed Act monies are to be used by the states. 2) The provisions of a stimulus package (should one be enacted) could affect the size of the Reed Act distribution. If, for example, there were to be a temporary extension of UI benefits to the long-term unemployed, the added payouts could offset Reed Act monies. At present, roughly \$4 billion is slated for return to the states. This could be totally eliminated under an extension of long term benefits.

*What else needs to be done for the long term?*

To use the Reed Act monies to increase solvency during a recession seems contrary to the intent of the UI program. While using funds to improve program administration is probably necessary in the long run, it would seem that bolstering the income of the unemployed and keeping many of them from falling into poverty are more pressing short-run concerns, especially during a recession.

Raising reciprocity among jobless workers is clearly another need of state UI programs for the long run. Last year's proposals to expand coverage for low-wage and part-time workers would have reduced hardship but they would have had only a modest impact on increasing the number of recipients. Also, none of the measures would have addressed the interstate variation in reciprocity rates. Increasing reciprocity in low-

reciency states would have a bigger impact on nationwide data than limited proposals to expand coverage to low-wage and part-time workers.

Access to UI benefits for low-wage and part-time workers is of special concern in the reformed welfare system. Many former welfare recipients have low-paying jobs, and a large number are likely to experience spells of unemployment, especially during recessions. Improving access to UI will help these workers avoid a return to welfare dependency.

*The views are those of the author and do not necessarily represent those of the Urban Institute, its board of trustees or its sponsors.*

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Chart 1. Continued Claims for UI Benefits, 1999, 2000, and 2001

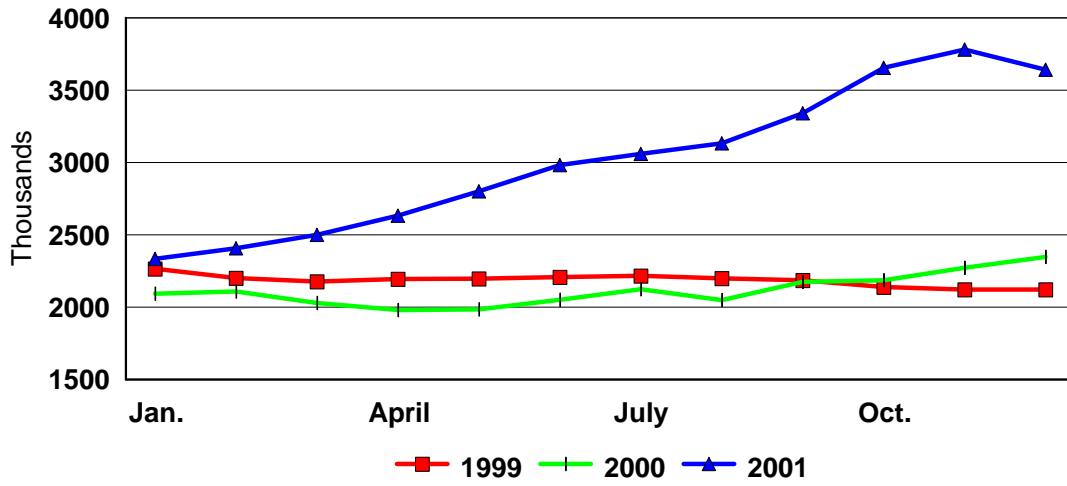
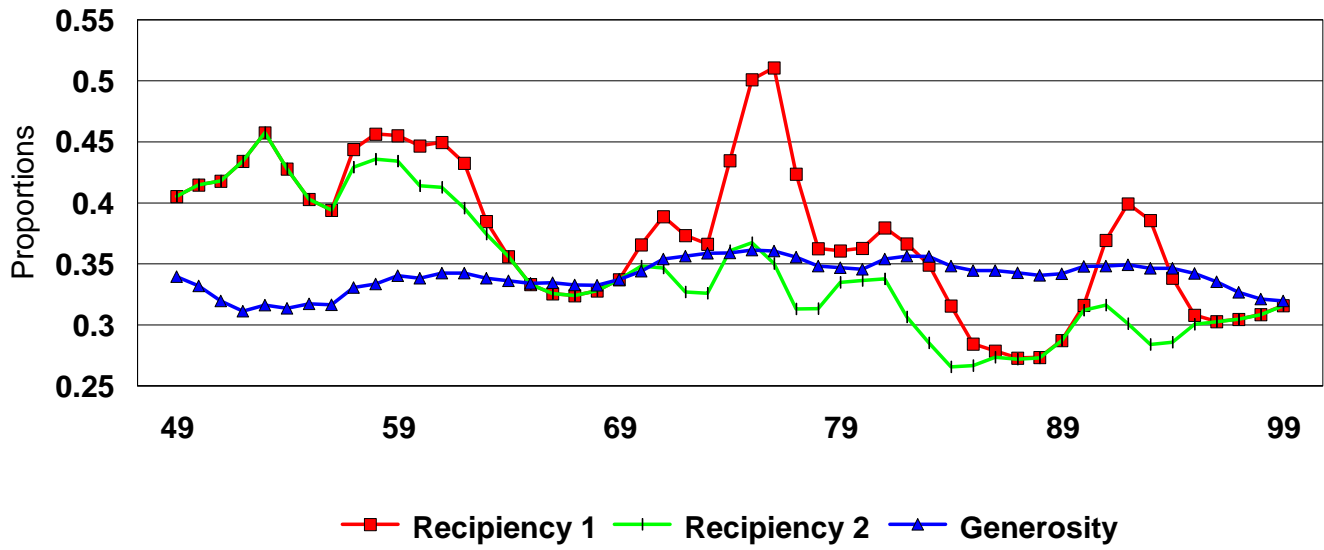


Chart 2. Unemployment Insurance, Long Run Trends in Reciprocity and Generosity, 1949 to 1999



Reciprocity 1 = (all beneficiaries(regular UI, emergency and EB)/unemployment), Reciprocity 2 = (regular UI beneficiaries/unemployment)  
 Generosity = (average weekly benefits/average weekly wages). All data centered three year averages.

# Reciprocity Rates by State, 1998-2000

