

Extending Unemployment Insurance (UI) Protection

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This short paper describes the current economic situation and argues for a further extension of federally-financed unemployment insurance (UI) protection to the long-term unemployed. It also summarizes important developments in the labor market over recent decades that are relevant to the current debate over extending UI benefits.

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UI Role During Current Downturn

Through the first three months of 2003 the U.S. economy has continued to grow at a slow pace with real GDP increasing at an average rate of 1.5 percent during the two most recent quarters. Slow growth coupled with continued gains in labor productivity have meant that employment has not increased much in more than a year. The present recovery has been characterized by sticky unemployment rates which have ranged between 5.6 and 6.0 percent of the labor force for the past 18 months (November 2001 to April 2003). During this period the number unemployed each month has ranged between 8.0 and 8.8 million persons.

The main pillar of income support for the unemployed, the UI programs in the states, has performed its traditional role during the current downturn. In the regular UI programs which are state-administered and state-financed, annual benefit payments increased from \$20.2 billion in 2000 to \$40.9 billion in 2002. Each week during 2002 and this year some 3.0-4.1 million persons have claimed regular UI benefits. These programs typically limit to 26 weeks the potential duration of benefits to the unemployed. Because of this limitation and because unemployment duration increases during recessions, many

¹ Economist, the Urban Institute. These views expressed in this document are the author's and do not necessarily represent views of the Urban Institute or its sponsors.

recipients use up (exhaust) their full entitlements before returning to work. During 2002, 44 percent of recipients of regular UI benefits exhausted their entitlements.

Last year the Temporary Extended Unemployment Compensation (TEUC) program was enacted in March. It pays up to thirteen weeks of benefits to persons who have exhausted regular UI benefits. Through the end of 2002 TEUC disbursed \$10.6 billion. The current five-month extension of TEUC is scheduled to expire at the end of this month. TEUC benefits totaled \$2.4 billion during the first three months of 2003.

Unemployment and Economic Hardship

During a typical (nonrecession) year there will be some 25-35 million new onsets of unemployment. These employment terminations are one aspect of turnover in the labor market, the result of decisions by workers and employers to terminate employment either through layoffs, quitting, the seeking of new jobs or the hiring of new workers. When the spells of unemployment are of short duration, say one or two months, the hardship experienced by individuals and their families is limited by the short interruption of their earnings stream.

As unemployment duration lengthens, however, the affected workers and their families are forced to make larger adjustments in spending due to the lack of income to maintain their former (pre-unemployment) standard of living. At the extreme end of such adjustments is the strong association between unemployment duration and poverty rates among families that experience unemployment. Poverty rates are three-to-five times as high for families with unemployment duration that lasts half a year or longer when compared to families where unemployment duration lasts three months or less, i.e., 30 to 50 percent compared to 10 percent.

The payment of UI benefits in situations of long-term unemployment has an important effect in maintaining family income and reducing poverty and associated economic hardships. During recessions this poverty-reducing effect of UI benefits assumes a larger role because the volume of long-term unemployment increases. The causal explanation here is simple: most of family income is derived from earnings and a long-lasting interruption of earnings leads to economic hardship.

Recent Developments in Unemployment Duration

Several developments in the U.S. labor market in recent decades have implications for unemployment duration and the volume of long-term unemployment.

Business Cycle Aspects

Three aspects of unemployment duration over the business cycle should first be noted. First, and most obvious, average unemployment duration increases during recessions. For example, the most common measure of average duration, mean weeks of unemployment from the household labor force survey (the Current Population Survey or CPS), increased from 12.6 weeks in 2000 to 16.6 weeks in 2002, or by more than 30 percent.

Second, average unemployment duration is a lagging indicator of the business cycle, often peaking in the year following the year of highest unemployment. Average duration was higher in 1976 than in 1975, higher in 1983 than in 1982 and higher in 1993 than in 1992. For all three pairs of years, the unemployment rate was higher in the earlier year but average unemployment duration was longer in the second year.

Third, average unemployment duration has been increasing. Thus mean duration in the CPS was 11.3 weeks during the 1950s, 11.9 weeks during the 1970s and 15.7 weeks during the 1990s. The contrast between the 1970s and 1990s is especially interesting since the average unemployment rate was actually lower in the latter decade, i.e., 5.8 percent during the 1990s compared to 6.2 percent during the 1970s. Thus average duration was about 30 percent higher during the 1990s while the overall unemployment rate was about 6 percent lower when compared with the 1970s.

Labor Market Changes

Two important changes have been occurring in the labor market that have implications for unemployment duration. The first is demographic and the second is a change in the employment contract. Both merit a few observations.

Demographic changes: The most obvious demographic change is the aging of the labor force. The combined effects of the maturation of the post-World War II baby boom and successor cohorts and delayed labor force entry of teens due to increased post-

secondary school enrollment have reduced the importance of young workers in the labor force. Young workers typically experience high unemployment rates but individual spells that typically are short. There is a well-defined positive gradient between age and unemployment duration. The decreasing share of young workers operates to increase average unemployment duration.

A second change, concentrated in the 1990s, has been the stabilizing of women's labor force participation. This has operated in recent years to reduce the volume of entrant and reentrant unemployment among women. The third change has been the relative deterioration of the unemployment rate among men vis-à-vis women. In decades before the 1980s the average unemployment rate for women was typically 10 to 20 percent higher than the male unemployment rate. During the 1980s and 1990s, however, average unemployment rates by gender have been equal. Men continue to have unemployment that responds more to the business cycle than women, and this explains why in April 2003 the adult male unemployment rate was 5.6 percent compared to 5.1 percent for adult women. The net effect of these changes in the demographics of unemployment is to lengthen average unemployment duration.

Employment Contract Changes: Even more important have been the changes in the employment contract. While fewer than one in five workers is now covered by a formal collective bargaining agreement (one in ten in the private sector), the arrangement for nonunion workers is often described as implicit contract governed by an invisible handshake. Employers commit to workers for reasons of long-term worker productivity and reputation even though no legally binding contract exists. One manifestation of the invisible handshake is the use of temporary layoffs in situations of inadequate demand. Workers are placed on temporary layoff with the understanding that recalls will occur when product demand rebounds.

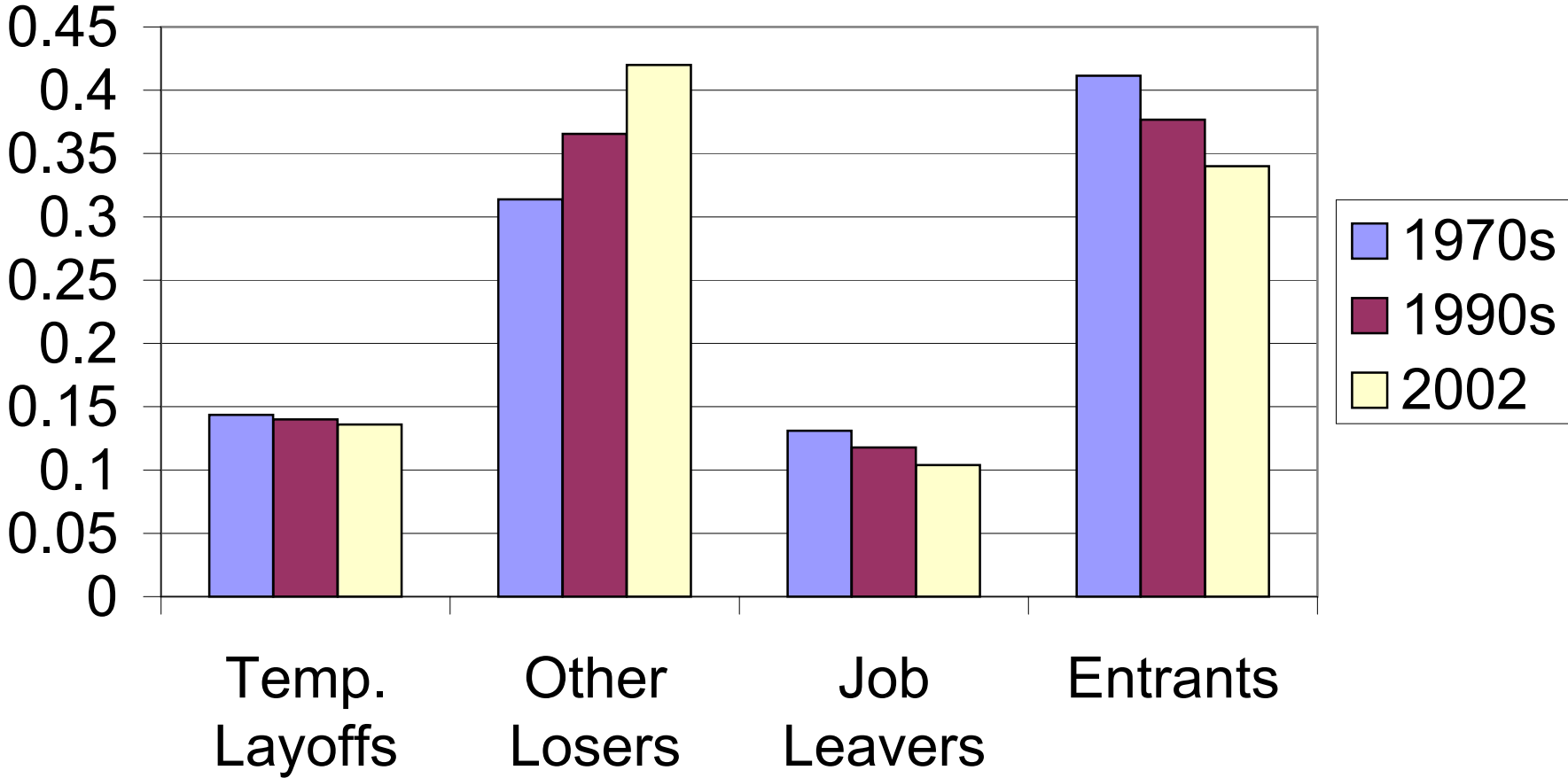
Reliance on the invisible handshake appears to be declining. This probably reflects developments facing the companies, e.g., more exposure to international competition and greater pressures to show favorable short run company performance indicators (profits) to owners (stockholders). Also, industries where temporary layoffs have been most prevalent, especially manufacturing, now account for a declining share of overall employment. As a result, the pattern of job loss during recessions has been

changing. Within the main categories of reasons for unemployment (measured in the CPS since 1967), employer-initiated separations are increasingly permanent separations while temporary separations are becoming less common. The patterns from the recession of the early 1990s and the current recession present vivid contrasts to earlier recessions of the 1970s and early 1980s. Permanent separations (termed “other job losers” in the CPS) have increased in importance while temporary layoffs have become less common. Temporary layoff unemployment during the initial recessionary years of the 1970s and early 1980s accounted for about 20 percent of total unemployment whereas the corresponding shares in the past two recessions have been in the 15-16 percent range. The category “other job losers” has become correspondingly more important during these last two recessionary episodes.

While many factors may contribute to this change in employer behavior, those who experience permanent job losses have much longer spells of unemployment compared to those on temporary layoff. Thus a change in the mix of employer-initiated separations is an important factor leading to longer average unemployment duration in the economy. This change is most noticeable and important during recessionary periods when successful job search is especially difficult.

Reasons for Unemployment: Chart 1 summarizes the effects of demographic change and change in the employment contract, showing data on unemployment by reason during the 1970s and 1990s. During the 1990s three reasons became less important in the mix of unemployment, i.e., temporary layoffs, quits (job leavers) and entrances and reentrances into the labor force (combined as entrants in Chart 1). The fourth reason, other job losers (employer instigated separations for any reason other than temporary layoffs), became more important, and this group has the longest average unemployment duration. In sum, the group with the longest average duration increased its percentage share of unemployment by five percentage points between the 1970s and 1990s.

Chart 1. Shares of Unemployment by Reason: 1970s, 1990s and 2002



Source: Analysis of data from www.bls.gov, Urban Institute, 2003

In the current recession “other job losers” constitute the largest single share of unemployment by reason. Chart 1 shows that during 2002, they (other losers in the chart) accounted for 42 percent of total unemployment, larger even than the share for entrants. These are disproportionately experienced workers, but also workers who find reemployment to be difficult as evidenced by their long average unemployment duration.

What Should be Done?

The expiration of TEUC at the end of May will add to economic hardships for many workers. Current proposals of the Bush Administration place heavy emphasis on individual choice through the vehicle of Personal Reemployment Accounts (PRAs). The proposal would make available \$3.6 billion to the unemployed over the next two fiscal years to use for retraining and other activities intended to speed reemployment. Individual workers would control up to \$3000 to support reemployment activities or to use for income support as with traditional extended benefits like TEUC.

If enacted this proposal would assist a number of the long-term unemployed and is worthy of support. Particularly for the “other job losers,” training, job search assistance and other reemployment support would be important for speeding their return to employment. However, PRAs are not an adequate substitute for the traditional federal response which would be a further extension of TEUC. Most of the long-term unemployed are in that situation because of the business cycle and the evolving pattern of job losses that have characterized the current downturn.

There simply are too many long-term unemployed seeking jobs for the PRA proposal to effectively serve of this group that is experiencing the most serious economic hardships. Consider the following. In April there were 2.0 million unemployed persons with duration of 27 or more weeks. Their situation is not potential long-term unemployment, it is actual long-term unemployment. Support of each person through a \$3000 PRA would cost \$6.0 billion, far exceeding the total proposed two-year allocation of \$3.6 billion to PRAs.

The immediate federal policy response should be to enact a new extension of TEUC, possibly combined with PRAs.

About the Author

Wayne Vroman is an economist at the Urban Institute. He has studied various aspects of the Unemployment Insurance Program for Over 30 years.

Other Publications on Unemployment Insurance by Wayne Vroman

“Low Benefit Reciprocity in State Unemployment Insurance Programs,” ETA Occasional Paper 2002-02 (Washington, D.C.: U.S. Department of Labor, 2002).

“An Analysis of the Virginia Unemployment Compensation System,” report to the Virginia Employment Commission, December 2002, also available at

<http://www.urban.org/url.cfm?ID=410606>.