

# UNEMPLOYMENT INSURANCE IS IN DESPERATE NEED OF MODERNIZATION

## A Comment on “Weathering Job Loss”

Howard Rosen  
Peterson Institute for International Economics

The U.S. labor market has undergone significant changes over the past few decades. The primary cause of unemployment has shifted from cyclical to structural factors. Although the overall unemployment rate has been falling, the duration of unemployment has been rising. These changes have taken place across the country, as unemployment rates have converged across states.

U.S. labor market adjustment programs, designed to address conditions that existed decades ago, have not kept up with these developments. For example, unemployment insurance (UI), designed in response to the Great Depression, does not provide assistance to the majority of unemployed workers, leaving millions of workers without the assistance they desperately need.<sup>1</sup>

UI's original goals were to smooth a worker's income stream by providing income support during periods of unemployment, to provide insurance against the risk of job loss, and to serve as a counter-cyclical stimulus during periods of economic downturns. In achieving these goals, it would also reduce the incidence of poverty among low-income families who face unemployment and have little savings to fall back on.

The following program indicators suggest that the current UI program falls short in meeting all of these goals:

- The average reciprocity rate—that is, the percent of unemployed receiving UI—over the past 27 years is approximately 37 percent.
- The average replacement rate between 1975 and 2004—that is, the amount of assistance relative to a worker's *previous* wage—was 0.36, far short of the initial goal of 50 percent.<sup>2</sup>

- The exhaustion rate—that is, the percent of workers who exhaust their benefits before finding new jobs—averaged approximately 30 percent between 1974 and 2007.

Simms presents data that show that the incidence of unemployment for low-income workers is twice that for medium- and high-income workers combined: 15.1 percent for low-income workers versus 7.2 percent for medium- and high-income workers. By contrast, the reciprocity rate for low-income workers (the percent of unemployed workers receiving UI), is 60 percent of that for medium- and high-income workers combined: 22.4 percent for low-income workers versus 37.2 percent for medium- and high-income workers. Ironically, although low-income workers may need UI more than medium- and high-income workers, the program works better for medium- and high-income workers than for low-income workers.

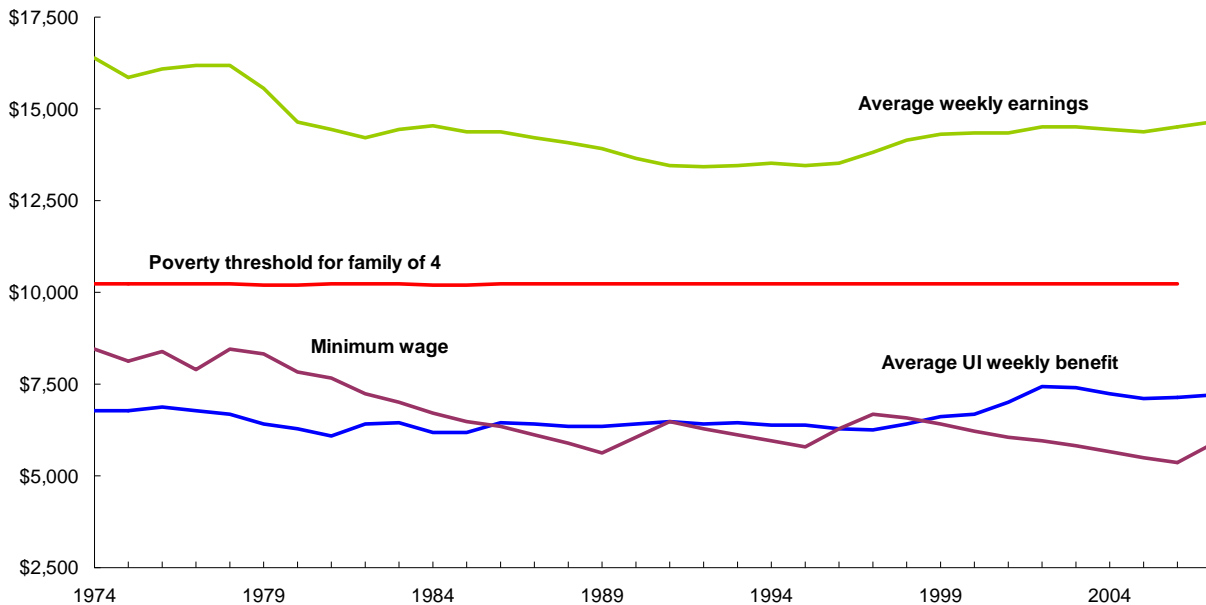
As Simms reports, UI constitutes an important source of income for unemployed workers and their families, particularly for the long-term unemployed. Simms references a 2004 Congressional Budget Office report that indicates that UI benefits played a significant role in maintaining the family income of recipients who experienced long-term spells of unemployment in 2001 and early 2002, particularly for those families that had only one wage earner. Before becoming unemployed, recipients' average family incomes were about \$4,800 a month. Those workers who received UI experienced a 40 percent drop in income, relative to a 60 percent drop among workers who did not receive UI.<sup>3</sup>

Restrictive eligibility criteria constitute a large hole in the existing UI program. The current look-back and job tenure provisions, as well as the exclusion of contingent workers (temporary and part-time workers), particularly affect low-income workers.<sup>4</sup> Thirty-seven states do not provide dependent payment supplements. Only workers in firms with 50 or more employees are eligible for the Family and Medical Leave Act (FMLA). In any case, as Simms reports, FMLA only enables workers to take leave for family reasons; it does not provide for payment of wages during that leave.

The national average weekly benefit in 2007 was \$287.71. After taking inflation into account, the real value of the national average weekly benefit has not changed much over the past 30 years. Nor has it changed much relative to the poverty threshold or average weekly earnings. It has improved relative to the minimum wage only because that was not increased for a decade.

Figure 1 presents the real annualized value of the national average UI weekly benefit relative to the real annualized value of the hourly minimum wage, the poverty threshold for a family of four adjusted by inflation, and the annualized value of the real average weekly wage for all workers. On average over the past 35 years, the real value of the weekly UI benefit has been about 40 percent below the poverty rate for a family of four adjusted by inflation, and approximately 44 percent of real average weekly earnings.

**Figure 1. Comparison of Weekly UI Benefits and Other Income Measures**



Simms’s essay addresses many of the problems identified in the program and makes recommendations to help the UI program better meet its initial objectives and be more inclusive of low-wage workers. I agree with all of them, including these four:<sup>5</sup>

- Shift the determination of eligibility to hours rather than earnings
- Amend the work test to allow job search for part-time employment
- Standardize benefit levels to at least half of *lost earnings*
- Increase the federal taxable wage base, in steps, from \$7,000 to \$45,000

In addition, I propose the following four reforms:

- Set a maximum weekly benefit equal to two-thirds of state average weekly earnings
- Fix the extended benefit triggers so they are more automatic and workers can receive assistance during economic downturns without disruption
- Standardize allowances for dependents across all states
- Provide a Health Coverage Tax Credit (HCTC) similar to the one currently included in the Trade Adjustment Assistance program

Despite significant changes in U.S. labor market conditions, the basic structure of UI has not changed since it was established 70 years ago. As a result, UI does not currently meet its initial goals. Although low-income workers need UI more than medium- and high-income workers, the program works better for medium- and high-income workers.

Changes necessary to move UI into the 21st century require significant federal leadership. The very basic structure of UI must be reformed, broadening from the single-employer, full-time worker, temporary layoff model to an approach that accommodates permanent job loss, part-time or contingent work, self-employment, and the incidence of job loss and national, rather than local or regional, unemployment. American workers are currently facing considerable pressure from corporate restructuring, technological change, and increased competition from home and abroad. These pressures are likely to intensify as the economy faces new challenges. Reforming UI is an important step toward providing workers with the assistance they need to adjust to these challenges.

## Notes

<sup>1</sup> See Kletzer, Lori G., and Howard F. Rosen, "Reforming Unemployment Insurance for the Twenty-First Century," The Hamilton Project, Discussion Paper 2006-06 (Washington, DC: The Brookings Institution, 2006).

<sup>2</sup> Author's calculations based on Department of Labor data.

<sup>3</sup> Long-term recipients are defined in this report as unemployed workers who received UI benefits for a spell of at least four consecutive months, in 2001 or early 2002.

<sup>4</sup> Some workers associated with temporary placement agencies may receive UI. Twenty states currently do not cover part-time or temporary workers.

<sup>5</sup> See Kletzer and Rosen (2006) for a more complete list of reform proposals.