Unemployment Insurance in the American Recovery and Reinvestment Act (HR1)

Wayne Vroman

The economic stimulus bill enacted on February 17, 2009 has several provisions related to unemployment insurance (UI). Several governors have objected to some provisions. In this document, Senior Fellow Wayne Vroman, an economist and researcher on UI, answers key questions about the program changes.

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Q. What does HR1 include for Unemployment Insurance (UI)?

HR1 includes five separate provisions that increase UI benefit payments to the unemployed. The provisions affect all three tiers of UI benefits. The bill also addresses health insurance coverage among the unemployed. Additionally, it provides short-term relief from interest charges arising from loans to states after their UI trust funds have been exhausted by the high volume of recession-related benefit payments. Most important in HR1 are the benefit provisions.

Q. The Unemployment Insurance program has several types/levels of benefits. Which ones are affected by the stimulus package?

State UI programs have three tiers or levels of benefit payments. The first tier is the regular UI program that can pay up to 26 weeks of benefits to eligible claimants. States finance regular UI with payroll taxes levied on covered employers. The second tier is the Federal-State Extended Benefits (EB) program, which is activated when a state's unemployment exceeds a predetermined threshold. Once activated, EB can pay benefits for up to 13 or 20 weeks to claimants who have exhausted regular UI. In the past, EB has been financed on a 50-50 basis by state and federal governments. As of March 8th, thirteen states were paying EB. The third tier is temporary federal benefits (TFB) created by federal legislation and available to claimants who have exhausted all regular UI benefits. The current TFB program, Extended Unemployment Compensation (or EUC), was created in July 2008, extended in November 2008, and further extended by HR1 through the end of 2009. Depending upon the state's unemployment rate, a person can collect EUC for 20-33 weeks in 2009 and into the first five months of 2010. These benefits are fully funded by the federal government.

Q. How are Extended Benefits (EB) "turned on"? Can you describe the seemingly complicate trigger choices?

EB may be activated by one of three possible "On" triggers. The trigger that all states use has a two-part calculation. The insured unemployment rate (IUR, regular UI claimants as a percentage of covered employment) must average at least 5.0 percent during thirteen consecutive weeks and be 120 percent or more of the average IUR for the same thirteen weeks of the previous two years.

There are also two optional EB triggers. The thirteen- week IUR is at least 6.0 percent regardless of its level during the same period of preceding two years. All but 12 states have this trigger. And, finally, the TUR (short for total unemployment rate, the rate calculated for each state by the Bureau of Labor Statistics and recognizing all unemployed persons, not just UI claimants) for three consecutive months must average at least 6.5 percent and be 110 percent or more of the TUR for the same period in at least one of the two previous years. Just 12 states have this trigger.

Of the three triggers, the 6.5 percent TUR -110 percent trigger is the easiest to activate while the 6.0 percent IUR trigger is the most difficult. Among the fifteen EB programs active during the week of March 15, 2009, six used the TUR-110 percent trigger while none used the 6.0 percent IUR trigger and nine used the 5.0 percent IUR-120 percent trigger.

Q. If an unemployed worker qualifies for UI, what additional benefits would he/she automatically have access to regardless of state action?

Perhaps one of the most important changes is higher weekly benefits. The average weekly UI benefit is increased by $25 per week for all recipients of regular UI, EB, and EUC. The $25 represents an 8-percent increase over the national average weekly benefit of 2008. Because the same flat amount is paid to all beneficiaries, this addition is more important to claimants with low weekly benefits and claimants in states with low weekly wages.

To bring this to ground level, the $25 represents 6 percent of average weekly benefits in Hawaii but 14 percent in Mississippi, the states with the highest and lowest weekly benefits in 2008. Those with the lowest weekly benefits would likely spend the greatest fraction of these added benefits. While there have been many past temporary federal programs, this legislation is the first to pay higher weekly benefits during a recession. In the past, potential benefit duration was extended by TFB programs, but weekly benefits were not altered.

Another new benefit is the income tax waiver of $2,400 on UI benefits. UI benefits were first taxed under the federal personal income tax in 1979, and they have been fully taxable since 1986. This is the first reversion of the tax status of benefits since 1986. The impact of this provision is limited since the marginal tax rate on UI benefits is low, estimated at 10 to 15 percent. Both provisions affecting weekly benefits came into force during the benefit week ending February 28, 2009. States will find both easy to administer.

Q. Is COBRA coverage part of the plan?

Yes, HR1 also provides up to nine months of subsidized COBRA coverage for UI claimants who lose health insurance. The subsidy is 65 percent (claimants must still pay 35 percent). COBRA is not inexpensive. Its average annual cost during 2008 was $4,704 for a single person and $12, 680 for families. These amounts translate into out-of-pocket weekly costs of $32 and $85, respectively. That's about 11 percent and 28 percent of average weekly UI benefits.

The cost estimate for this provision is $24.7 billion. The estimate is necessarily rough, though, because the number who lose health insurance is uncertain, and even paying 35 percent of COBRA costs could discourage many (perhaps most) "eligibles" from participation. In short, the number eligible and the take-up rate are both highly uncertain.

Q. What additional benefits are available in states with very high unemployment rates?

First, federally funded EUC has been extended. Before HR1 was enacted, the EUC program was to stop new claimant intake after the last week of March 2009. HR1 extended this deadline to December 31, 2009. Individuals exhausting benefits between April and December would be entitled to either 20 or 33 weeks of additional benefits under this EUC extension. At current state unemployment rates, 18 states could pay up to 20 weeks of EUC while 33 states could pay up to 33 weeks.

Another benefit would flow from activating EB. The EB program has been very limited in scope since the early 1980s when changes in triggering mechanisms made activation much more difficult. During the recession of 1991, just nine states activated EB; in the 2001 downturn, six did. Most states that activated EB in these two prior recessions did so for the minimum three-month period. For 33 states, the most recent "on" period was 1981-1983. In the current recession, 13 states had activated EB in the week ended March 8, 2009. Several others were closely monitoring their EB triggers for possible activation.

This EB provision in HR1 also has a generous reach-back feature. Eligibility for the added 13-20 weeks would extend to regular UI "exhaustees" with base periods that ended more than one year before HR1 was enacted. However, to be eligible for the added EB payments, the state would have to enact the alternative 6.5 percent TUR-110 percent trigger.

Q. If states are having financing problems, why would they extend benefits?

To induce states to temporarily increase access to EB, HR1 commits the federal government to pay up to 13 or 20 weeks of EB (20 weeks in states with higher unemployment) to persons who exhaust EUC and commence an EB benefit period in 2009. These benefits may be paid into 2010, depending upon the 2009 start date for EB benefits (20 weeks could extend to May 2010). During these months, the federal government will finance all EB benefits, not just the standard 50- percent federal share. To qualify for funds for these added weeks during 2009 and early 2010, many states would have to enact the 6.5 percent TUR-110 percent trigger (See above). This EB extension could be temporary if states enact a sunset feature, with EB reverting to its previous trigger(s) after 2009. Note too that *federal restrictive rules for EB eligibility are maintained during 2009. In the 13 states with no waiting period, all EB recipients must wait one week anyway and be subject to more restrictive job search and suitable work requirements (compared to regular UI).*

During January 2009, the TUR equaled or exceeded 6.5 percent in 33 states. Thus, the so-called alternative TUR trigger would substantially broaden the scope of EB during the present recession. States would not incur the extra costs for these benefits during 2009 and the early months of 2010 due to full federal funding.

Which ARRA provisions require states to change their eligibility criteria before additional funds are available to them? Will it cost the states anything to make these changes?

The act includes incentives for states to expand regular UI eligibility. This provision would make added monies available to states that already have or that adopt specified permanent increases to regular UI benefit eligibility and forego the sunset option. If all states adopted the appropriate three required features, come $7.0 billion would be disbursed from a federal UI trust fund (the Federal Unemployment Account or FUA) directly into the state trust funds that pay regular UI benefits. States could use up to $500 million of the added monies to enhance their budgets for UI program administration and/or Employment Service (ES) program administration.

To be eligible for any added monies, a state would have to have or establish an alternative base period (ABP). In all but a few states, the regular base period is the earliest four fully completed quarters of the past five fully completed quarters while the alternative base period is the last four fully completed quarters. For a February 2009 applicant, the regular base period is October 2007 through September 2008 while the ABP is

January 2008 to December 2008. This eligibility feature recognizes more recent earnings than the traditional base period, which increases monetary eligibility among workers with low wages or irregular work patterns. The 19 states with an ABP would qualify for one-third of their share of the $7.0 billion.

To be eligible for the remaining two-thirds, a state with an ABP would need to have two of the following four provisions. 1. *Enhanced eligibility for "quits" for compelling family reasons*-- to care for ill or disabled immediate family members (children, spouse, parents), follow a spouse whose job has been transferred to another location, or to escape domestic violence. 2. *Enhanced eligibility for part-time workers*. Roughly half the states require the unemployed to be seeking full time work to be eligible for benefits. This provision requires states to allow eligibility if the claimant previously worked part-time. States would decide how to treat a previous full-time worker now seeking a part-time job. The U.S. Secretary of Labor would decide what constitutes part-time work. 3. *If a state pays dependents' allowances, an allowance of at least $15 per dependent per week must be paid to all claimants with dependents*. The maximum limit on these allowances must be at least the lesser of $50 or 50 percent of the statewide average weekly benefit for the year. 4) *Weekly benefits would continue for those who have exhausted benefits but are enrolled and progressing satisfactorily in a training program that lasts for at least 26 weeks*. States already having two of these provisions would qualify for the two-thirds while other states would have to have to have two provisions effective before October 1, 2011.

Current estimates suggest that the added monies would cover the costs of the enhanced benefits for roughly seven years. After that, the increased benefits imply added costs to states. More precise estimates of the number of years covered by the added monies would depend upon such various factors as the specific provisions enacted and the structure of the state's economy. States with these provisions would receive an immediate infusion of monies into their trust funds, but, at the same time, would be assuming higher UI benefit costs over the long run.

Q. What features of ARRA's unemployment compensation provisions are the governors displeased with? How much money are these provisions going to cost them?

Interestingly, the $7.0 billion in potential incentive payments (some 14 percent of the estimated $50 billion) has generated the most public discussion and controversy since HR1 was enacted. Several governors say they will not make the indicated changes because of the implied long-run UI cost increases and the infringement upon state sovereignty in determining UI benefits.

Q. If it won't cost the states money for seven years, why are they so concerned about these changes?

Many describe the UI program as having two clients: claimants who receive benefits and employers whose payroll taxes finance the program. From their public statements, the governors voicing the objections apparently feel a greater sense of responsibility to their employer community than to their claimant community. Many of the states that are objecting currently have among the nation's lowest effective UI tax rates and the lowest UI recipiency rates. Their tax rate differential vis-a-vis other states will grow somewhat if they do not make the indicated changes in benefits while other states do.

Q. Are the governors wrong? Is there no short- term cost to the states for making benefits available to more people?

True, there will be greater costs in the long-run, but there will also be immediate infusions into trust funds that are low in many of the states crying foul. The point at which the added costs exceed the immediate infusions has been estimated to be seven years into the future. Thus, the annual cost increase for enacting three benefit enhancements (the ABP and two of the other four identified above) falls into the 10-15 percent range. Having a more precise estimate of these new costs would deepen the public understanding and clarify the discussion of these provisions.

HR1 also adds $0.4 billion through a special transfer from a federal UI trust fund account (the Federal Unemployment Account, or FUA) to the states to cover UI and Employment Service ES administration. These monies can be used to defray four types of administrative costs: 1) administration of the new provisions of HR1, 2) outreach to identify eligible non-filers, 3) improvements in UI benefit and tax administration, and 4) increased re-employment services to UI claimants. Also, as noted above, up to $0.5 billion of the $7.0 billion of UI modernization monies can also be used for administrative activities. Each state's share of these monies is based upon its proportional share of federal UI taxable payroll.

Of these two potential sources for administrative monies, the first is dedicated to administration while the second is fungible. Based on past experience with the special Reed Act distribution of 2002 and states' widespread current trust fund problems, several will likely use all their incentive (or "modernization") monies for benefit payments and little or nothing for enhanced UI and/or ES administration. For such states, the added monies for administration will come totally from its share of the $0.4 billion special transfer.

Q. How much is all this going to cost the federal government?

According to the National Association of State Workforce Agencies [hyperlink to "Economic Stimulus Legislation, H.R. 1 Analysis of Workforce and Unemployment Insurance Provisions, February 2009], *the individual provisions have the following price tags for 2009: the extension of EUC - $27.0 billion, the $25 increase in weekly UI benefits - $8.8 billion, the $7.0 billion incentive payment distribution (so-called UI modernization) - $7.0 billion, suspension of federal income tax of the first $2,400 of UI benefits - $4.7 billion.* (See National Association of State Workforce Agencies (NASWA), "Economic Stimulus Legislation, H.R. 1

Analysis of Workforce and Unemployment Insurance Provisions House-Senate Agreement" (Washington, D.C.: NASWA, February 2009). The estimated costs of the EB provisions are more uncertain and as of mid-March 2009 cost estimates have not yet been published by USDOL or NASWA.

Q. How are the states going to pay for the extra benefits and administrative costs that the federal government doesn't?

The main financing provision of HR1 is the granting of interest waivers for states that borrow from the U.S. Treasury. For all new borrowing between January 1, 2009 and December 31, 2010, any interest accruals will be treated as having been paid, saving states an estimated $1.1 billion.

This provision also removes some of the pressure for debtor states to enact solvency legislation. Debtor states that defer action will accrue larger debts than with new solvency legislation. This will provide greater short run stimulus during 2009 and 2010 due to fewer regular UI benefit reductions and smaller tax increases than under new state solvency legislation. However, the need to make long-run improvements in solvency will likely not be addressed by many states with the largest solvency problems, so they will have larger trust fund debts after 2010.

Other Publications by the Authors

- Wayne Vroman