

A Dialogue:
Unemployment Insurance
and
Employment Service
Programs

INTRODUCTION

When President Clinton signed his 1999 budget proposals, he set in motion a reform of the Unemployment Insurance (UI) program. On March 13, 1998, Secretary of Labor Alexis Herman announced the next step: a Dialogue to examine the program and the related Employment Service (ES) program in light of a changing economy. The framework for this Dialogue is set forth in the enclosed paper. The Dialogue will allow interested parties to comment on a broad array of questions about the programs' effectiveness. The Dialogue will take place over the next year through several venues and forums. This paper provides a framework for the Dialogue and summarizes issues for discussion. A Dialogue Technical Supplement will provide greater detail and will be issued shortly as a companion piece to this paper.

Why begin this discussion now when unemployment is hovering at a 24-year low and the economy is strong? Since the ES program was created in 1933 and the UI program was created in 1935, the economy has changed, the workforce has changed, the workplace has changed and the way we work has changed, affecting both workers and businesses. We need to assure that the system continues to provide temporary income to unemployed workers and to assist the workers in returning to work. We also need to assess the UI program's impact as an economic stabilizer for workers and for businesses.

To initiate this discussion, we will review the fundamental objectives and structures of the two programs and then examine current program performance. To facilitate the discussion, this paper describes the current environment, and presents information on the latest research. Comments are invited. Questions for comment and response will also be developed and issued with the Dialogue Technical Supplement.

Areas to be discussed in the paper include:

Individual Economic Adjustment: How well does the UI program help individual unemployed workers by providing adequate financial resources and promoting transition to employment? Who should receive benefits; what kinds of reemployment services should be provided and how could these reemployment services be made more effective?

Macroeconomic Stabilizer: How well does the UI program serve as a counter-cyclical macroeconomic stabilizer? That is, does the program serve to stabilize the economy locally? Regionally? Nationally? How could the program's performance be improved?

Insurance Concepts: How well does the UI program operate in terms of core insurance principles of forward funding, risk pooling, and solvency? How well does the program accumulate resources for payment during periods of economic downturn? How well does the program operate in terms of pooling risk for employers and States? What are the consequences of diverging from these insurance principles?

Financing Benefits: How should the UI benefit financing structure (including items such as the

taxable wage base, minimum and maximum rates, rate schedules) work to assure efficiency, equity and incentives? To what extent should employer tax rates be based on experience with unemployment? How could employer reporting and record keeping be streamlined?

Financing Administration: How should the administration of the UI and ES programs be financed? How well does the administrative financing system respond to workload changes over the business cycle? How should the administrative financing system encourage efficient and cost-effective operations?

Federal-State System: How should the Federal-State partnership work to assure a basic national UI program that reflects differences among the States? How can the partnership be improved? Are any changes needed in the division of responsibilities, such as financing, benefit structures, or oversight? What should be the relationship between UI and ES? What form should ES take in the future?

The paper provides of overview of the issues. Response methods and addresses are included in the Summary and Conclusion section.

A Dialogue: The Unemployment Insurance and Employment Service Programs

Enacted over sixty years ago as a Federal-State partnership, the Unemployment Insurance (UI) program has been a major source of temporary income support for laid-off workers who are seeking work. In addition, for over sixty years, the Employment Service (ES) program has served to assist workers in finding new jobs. Since the advent of both programs, the economy has changed, the workforce has changed, the workplace has changed, and the way we work has changed, affecting workers and businesses alike. At the same time, the UI and ES programs have changed as Federal and State laws have modified them to reflect national concerns and State differences.

Over the history of the program, coverage has expanded, so that 97 percent of all wage earners are now covered by the UI program. Currently, about eight million workers receive UI benefits each year. It is now time -- while the economy is strong and there are no pressures for urgent action -- to step back and assess how well the UI and ES programs are working. Are the program structures still effective in the current work environment? Are the right incentives in place for workers, employers, and the States to sustain a financially viable system that provides an effective safety net for laid-off workers while smoothing the transition to reemployment?

Some specific areas of concern have been raised by various observers. For example, while the UI program was not designed to cover all of the unemployed (for example, the self-employed are not covered), the declines in the share of the unemployed receiving UI benefits may signal that aspects of the program need to be changed. Since States have substantial control over the eligibility requirements and benefit levels in their UI programs and in the types of services provided by the ES, this produces variations across States. The declines in the solvency of State accounts dedicated to paying UI benefits have raised questions about the appropriate mix of approaches for assuring a financially viable system. In recent years, the UI and ES programs have had to compete against other programs for Federal administrative resources in an extremely tight budget environment. While program administration has become increasingly automated, there are concerns about the impact on customers as claimants for UI benefits and as job-seekers. In view of these observations and concerns, we need to assure that the UI and ES programs continue to help unemployed workers and assist them to return to work.

This paper has been written to facilitate discussion of the status of the UI and ES programs. It begins with a discussion of current economic trends and the core features of the UI program. It then moves on to what we term the "Dialogue Issues." Each Dialogue Issue contains a brief discussion of the current status of the program.

Current Economic Environment

The current economy is strong and unemployment is low. Jobs are being created. In some cases,

there are notable skill shortages, such as in the information technology field. At the same time, jobs are being lost, and workers are shifting from one industry to another. The issue for the UI and ES programs is to determine to what extent they are adequately providing wage replacement and promoting the transition to new jobs, and to what extent UI needs to prepare for future downturns.

Three major macroeconomic forces are shaping our economy and our workforce: technological change, increasing global competition, and changing demographics. Taken together, these changes have resulted in growth of technology jobs, increased imports and exports, and increased representation of older workers, women and immigrants in the labor market. These economic forces have rippled throughout the workplace. Much of manufacturing employment has shifted into the service sector. Throughout the economy, workers are changing jobs during their work lives, both voluntarily and involuntarily, more often than ever before. Many workers are looking for alternative work arrangements to address the needs of two-income families and retired workers. Non-standard employment relationships continue to grow, as both employers and workers seek more flexibility.

What are the implications of these economic changes for the UI and ES programs? Some State UI eligibility requirements may not be designed to deal with part-time and other non-standard employment relationships. Greater job mobility poses difficulties for two-earner families when a spouse has to quit a job to relocate. Permanent job loss, rather than cyclical or seasonal unemployment, requires greater use of reemployment services. Do workers have access to programs that are designed to provide a safety net for the involuntarily unemployed and assist them to find reemployment?

Congressional Perspective for Viewing Program Effectiveness

Any discussions concerning the UI and ES programs must examine whether they are effectively accomplishing their objectives. In broad terms, Congress established its views on the importance of measuring program effectiveness when it passed the Government Performance and Results Act of 1994. This Act requires Federal agencies to devise strategic and performance plans and to report to Congress on program performance. Congress will use this material to determine program effectiveness and, potentially, program funding. Because the ES and the administrative costs of the UI program are funded through congressional appropriations, program performance and outcome information are important.

UI Program Mission and Principles

Established in 1935, the UI program provides temporary partial compensation for wage loss to eligible workers during periods of involuntary unemployment caused by layoffs. It was designed to promote economic stability by maintaining purchasing power and preventing the dispersal of an employer's trained workforce. The UI program is the largest worker protection program for job loss. It is not means-tested and is available for all eligible workers. Another key feature of

the original UI program is that the amount of State UI taxes be based on an individual employer's experience with unemployment. This feature was designed to encourage greater stability in employment by creating a financial disincentive for employers to lay off workers.

The principal components of the UI program involve payment of benefits, funding of benefits and administration of the program. A fundamental principle is that benefits should provide an adequate cushion while the claimant is searching for suitable work. For the program to provide macroeconomic stabilization, these benefits must be available to a sufficiently large portion of job losers.

A basic benefit funding principle is that the UI program be self-financing. This is typically taken to mean that funds should be accumulated during periods of economic growth so that they will be available to pay benefits during economic downturns. (This is often referred to as "forward funding.") Given the uncertainty of the business cycle, employers share in or pool the risk of unemployment by contributing to a State unemployment fund which pays out benefits. The individual employer generally does not pay the full cost of the event that is insured against at the time the event occurs, although over time its tax rates reflect its experience with unemployment.

The self-financing principle also has a Federal component. Federal UI taxes build up balances to pay the Federal share of Federal-State extended benefits, which are payable during periods of high unemployment, and to provide repayable loans to States whose accounts have become insolvent. In both cases, these Federal funds are available to all States without regard to how much Federal tax the employers in a State have paid.

States and the Department of Labor share responsibilities for program administration. Each State operates its UI program in accordance with its law, but State law is required to conform with certain basic provisions of Federal law. Administrative funding for the UI program and 97 percent of funding for ES programs comes from Federal UI taxes. Congress appropriates administrative funds which are allocated based on individual State program needs/requirements without regard to contributions by employers in the States. Federal UI taxes also pay Federal administrative costs. The Department of Labor also provides technical assistance and oversight to the States.

From the beginning of the program, Federal law required that UI be paid through public employment offices or such other agencies as the Secretary of Labor may approve. This meant that there was a connection between the UI program and the ES program as well as to employment services provided for veterans. The Department of Labor has interpreted Federal law to mean that claims personnel or employment service personnel give workers appropriate assistance in finding work. UI claimants identified through a profiling system as likely to exhaust their UI benefits and needing assistance to find new employment are referred to reemployment services, which are usually provided by the ES and sometimes by programs under the Jobs Training Partnership Act (JTPA).

Dialogue Issues

Individual Economic Adjustment. This Dialogue Issue is concerned with how well the UI program helps individual unemployed workers by providing adequate financial resources and promoting transition to reemployment. It is also concerned with who receives benefits, what kinds of reemployment services are provided by ES, and the effectiveness of these services. Following is information on the current situation.

Historically, the trend in UI has been to increase coverage of workers. In the beginning of the program, only firms with eight or more workers were covered. This included about 73 percent of the workforce. Today, an estimated 97 percent of wage and salary workers are covered. The largest excluded class of workers is the self-employed, including independent contractors.

To qualify for benefits, a worker must demonstrate previous attachment to the labor force, measured by the amount of earnings in covered employment during a "base period," which is usually the first four of the last five completed quarters before a claim for benefits is filed. Thus, base periods in most States do not include the most current wages. In fact, as many as six months of recent employment can be omitted from the determination for UI benefits. Generally, States require a worker to have earnings totaling \$1,000 to \$3,000 in at least one quarter in the base period and many require additional earnings in another quarter.

Once a worker meets this test, the State determines the reason for the unemployment. In most States, workers who quit work without good cause connected to the work, commit misconduct connected with the work, or refuse suitable work will be disqualified from receiving benefits. For example, if a worker voluntarily quits a job without good cause, virtually all States require the disqualified worker to return to work for a certain period before requalifying for benefits. Other types of disqualifications, such as those for a specific number of weeks, are possible. The specific periods of disqualification and determination of what constitutes good cause reflect the decisions of individual State legislatures.

The worker must also demonstrate continuing eligibility on a week-to-week basis. Federal and State law require that benefits be paid only to eligible unemployed workers who continue to be able and available for suitable work. All workers are required to certify for each week for which they claim benefits that they are able to work and available for suitable work. State ES staff assist in this process by administering what is called the work test and by notifying UI staff if a worker refuses an offer of suitable work.

Although eligibility conditions are largely established through State laws, Federal law imposes a few eligibility conditions, some to deny benefits and some to allow benefits. For example, Federal law requires, with some exceptions, that States deny benefits to teachers between terms. It also requires that workers who are in approved training be allowed benefits if they are otherwise qualified. The Extended Benefits program imposes rigorous work search and suitability of work provisions. Federal law has also created the opportunity for two special

benefit programs which States may administer on a voluntary basis. Under the short time compensation program, benefits are paid to workers whose employers choose to reduce the hours worked each week for all workers in lieu of full-time lay-offs for some workers. Under the self-employment assistance program, a worker may elect to receive self-employment assistance payments in lieu of UI, provided the worker meets certain conditions.

Most States replace, on average, half or less of lost pre-tax weekly wages. (While UI benefits are subject to income taxes, they are not subject to payroll taxes.) All States cap the amount of benefits they will pay for a week. The lowest State cap is \$180 and the highest (without dependents allowances) is \$390. The highest with dependents allowances is \$573. (Generally, UI benefits are based on prior earnings, although 13 States provide for dependency allowances which take into account how many individuals are dependent on the worker.) All but two States provide a maximum duration of 26 weeks of benefits during the 12 months following the filing of the claim. In 1997, the national average pre-tax wage replacement rate was 47 percent with a range of 32.2 percent to 57.3 percent. During periods of high unemployment in a State, a permanent program of extended benefits, required by Federal law since 1970, provides an additional 13 weeks of benefits and provides for, as an option, seven additional weeks of benefits beyond that 13. In addition, Congress has enacted supplemental extensions of benefits in most recent recessions.

How well the UI program is performing in terms of reaching unemployed workers has traditionally been measured using the reciprocity rate, which is the ratio of those receiving UI to the total unemployed. In the 1950s, the reciprocity rate averaged 49 percent, whereas during the 1990s it has averaged 35 percent. In 1997, States ranged from a low of 19.2 percent to a high of 59.3 percent. Another measure is the ratio of UI recipients to those involuntarily unemployed. In the 1970s, this ratio was 91 percent and in the 1990s the ratio is 71 percent. As can be seen, both measures are trending downward.

A number of factors have been identified as underlying the observed decline in reciprocity rates, although not all of the decline has been explained. More restrictive eligibility requirements and stricter penalties for disqualifications are part of the reason. Following the severe recession of the early 1980s, 33 States did not have sufficient funds to pay benefits and required loans from the Federal Government. To help repay these loans and avoid interest costs, many States raised taxes and tightened eligibility requirements.

Research shows that the changing labor force also contributed to the decline. Factors include shifts in unemployment from geographical areas with traditionally high reciprocity rates to areas with lower rates; reduced growth in industries with traditionally high claims, such as mining, construction and manufacturing; the decline in union membership where members are usually well informed about UI rights, increases in new entrants to the labor market (more women, more young individuals); and the taxation of UI benefits. Some State UI agencies believe the closing of local offices may also have affected reciprocity by forcing workers to travel farther to file for benefits. Some agencies also believe that more generous severance packages given some

workers may have also reduced reciprocity since receipt of severance payments reduce UI payments in many States. Given this varied set of reasons for the decline in UI reciprocity rates, the future actions for the UI program needed to be determined.

To facilitate individual economic adjustment, reemployment services are available to UI claimants through the ES and other programs and service providers. Generally, these services include job search assistance, counseling, testing, assessment, occupational and labor market information, job search workshops, job clubs, and referrals to employers. Additional benefits and services such as training, job search allowances and relocation allowances are available for claimants certified under the Trade Act, including those certified under the North American Free Trade Agreement Transitional Adjustment Assistance program. For claimants eligible under Title III of the JTPA, a variety of readjustment and retraining services are available. Specific services are available through ES local offices (which is the largest provider), JTPA service providers and a growing number of One-Stop Career Centers which combine these services. America's Job Bank and America's Talent Bank are automated systems that provide workers and employers on-line access to job and resume information as part of the One-Stop Career Centers.

Macroeconomic Stabilizer. This Dialogue Issue addresses how well the UI program serves as a counter-cyclical macroeconomic stabilizer. That is, how well does it stabilize the economy during economic downturns? It is concerned with whether the program's performance could be improved. Following is information on the current situation.

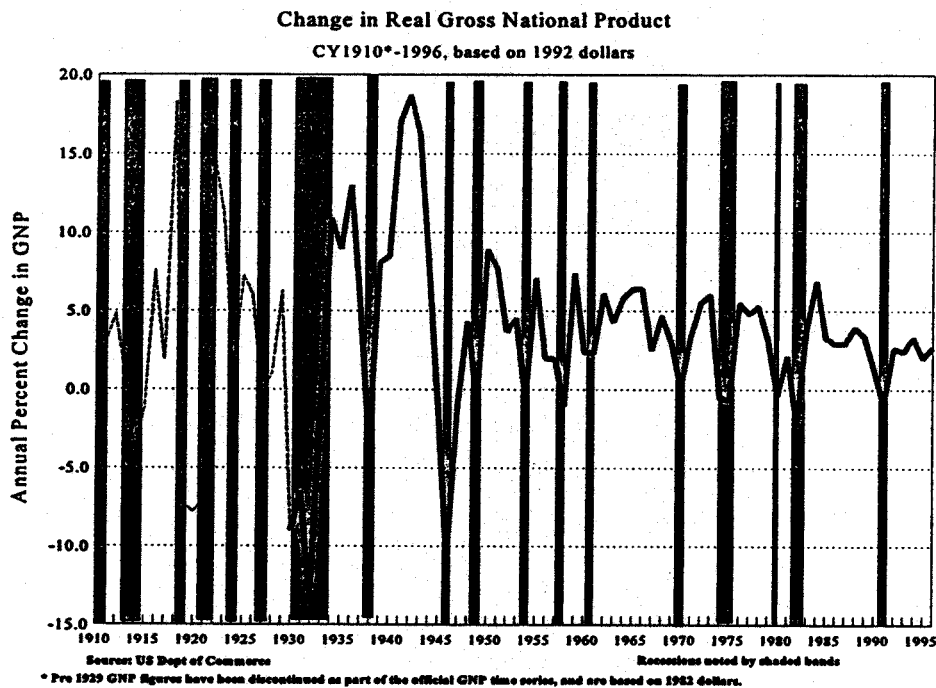
Economic stabilizers help to dampen economic fluctuations and improve the efficiency of the economy. During downturns, a high level of benefit payments maintains purchasing power and tends to revive (or at least maintain) economic activity. This stabilization effect is determined by the net injection of income or purchasing power into the economy, that is, the extent by which UI benefits paid exceed UI taxes collected. During prosperous times, the program has the opposite effect. As taxes collected exceed benefits paid, the economy is cooled somewhat, reducing the chance of inflation.

Measuring the stabilizing effect of UI involves substantial methodological challenges. Some studies have indicated that the UI program's effectiveness as an economic stabilizer has declined over time, but it is not clear how well these studies have dealt with some of the basic assessment problems this issue poses. The Department is supporting further research in this area, which may shed additional light on the subject.

After implementation of the UI program in 1938 and the transition to a post-war economy in the late 1940s, recessions were less frequent, generally of shorter duration, and less severe. Figure A shows the percent of change in gross national product, with the shaded areas defining recessionary periods. It also reflects the volatility experienced by the economy. This more stable economy helped create an environment in which businesses could grow and prosper and provide Americans with an increasing volume and variety of goods and services. Although a number of factors, including fiscal and monetary policy, contributed to the economic stability

reflected in the chart after 1950 and the impact of UI is very difficult to measure, the UI program is widely recognized as a key fiscal factor.

Another aspect of macroeconomic stabilization is the speed and magnitude of changes in UI benefits during recessions. Benefit payments increase immediately and significantly as unemployment increases. For example, benefit payments (excluding emergency programs) increased from \$9.9 billion in calendar year 1979 to \$16.6 billion in 1980 and then to \$24.2 billion in 1982. Similarly, in the most recent downturn, benefits increased from \$14.6 billion in 1989 to \$26.1 billion in 1991.



Insurance Concepts. This Dialogue Issue deals with how well the program operates in terms of accumulating resources for payment during economic downturns. It explores notions of forward funding, solvency, and risk pooling. The goal is to have a financially viable UI program. Following is information on the current situation.

Risk pooling has long been promoted by the UI program. At the State level, employers share risk by contributing to a common fund that pays benefits to unemployed workers. At the Federal level, risk is shared through the Federal accounts -- financed by employer taxes -- which pay 50 percent of the costs of Extended Benefits and fund loans to insolvent States. These funds are disbursed to States regardless of amounts paid by State employers.

“Forward funding” is the process through which reserves are accumulated during good economic times to pay benefits during periods of economic downturn. It assures that benefit accounts have sufficient reserves to effectively face an economic downturn. When this is not the case, there are four choices: borrowing funds, raising taxes, restricting benefit availability, or reducing benefit amounts. Depending on how they are implemented, some of these choices, such as reducing benefits when workers most need them or raising taxes during recessions, raise concerns about meeting the program’s goals of economic stabilization.

There are no Federal solvency standards, but a generally accepted measure of solvency involves comparing the current fund balance to possible future economic situations. Generally, two comparisons have been used. The first, called the “high cost multiple,” determines how many years of benefits the State’s fund could pay with no additional revenues at the highest level ever paid. The Advisory Council on Unemployment Compensation - a group mandated by Federal law to make recommendations on the UI program - recently recommended a variation on the high cost multiple called the “average high cost multiple.” This variation uses the highest three annual cost rates in the last twenty years or the last three business cycles to determine the number of years a State could pay benefits with no additional revenues. The Council further recommended an average high cost multiple of at least one.

Another solvency measure is the “reserve ratio” which is the ratio of the fund balance to total covered wages. Since benefits are based on earned wages, this ratio is relevant as it compares the amount of money available to pay benefits to a measure of potential liability. By this measure, the aggregate solvency of the State funds has shown a downward trend over time. In 1950, State fund balances represented 6.8 percent of total covered wages. By 1997, they were 1.5 percent of covered wages. Based on the States’ current trust fund balances and historical outlay and revenue patterns, an economic downturn of the magnitude of the 1980-82 recession would result in 25-30 States borrowing \$20-25 billion in order to pay benefits.

Financing the Benefits. This Dialogue Issue deals with how well the benefit financing structure works in terms of its efficiency, equity and incentives. To what extent are employer tax rates based on experience with unemployment? How can employer reporting and record keeping be streamlined? Following is information on the current situation.

In almost all States, benefits are financed entirely by employer taxes. (In two States, there are also employee contributions.) How much any one employer pays is determined by a variety of factors.

To meet Federal requirements, States which reduce employer tax rates must do so on the basis of experience with unemployment. Referred to as experience rating, this mechanism is designed to allocate more of the costs of unemployment to the employers whose workers experience unemployment, encourage employers to stabilize unemployment, and encourage employers to participate in the UI program to assure that determinations of eligibility are accurate. No

experience rating system is perfect. The degree of experience rating reflects trade-offs between fully charging an employer for the unemployment it is responsible for and sharing the costs (that is, spreading the risks) among other employers. Incentives need to be considered, but also equity. For example, some benefit costs are pooled because of the belief that the employer should not pay for the costs of benefits to workers in State-approved, but lengthy, training. Other benefits costs cannot be charged to an individual employer's account because the firm has gone out of business. Such costs are charged to a pooled account and distributed to all employers.

To gauge the effectiveness of experience rating, the Department of Labor publishes an annual Experience Rating Index. The index measures the degree of experience rating in a State. The median index for 1996 was 61 percent, meaning that 61 percent of all benefits were paid for by the employer causing the unemployment. The median has fluctuated around this level since the index was introduced in 1988.

Other factors also affect financing. State tax rates include minimum and maximum rates, causing some employers to pay more than their experience would require and some to pay less. For example, employers who have caused no layoffs pay some pooled costs. Some States provide for zero tax rates, and employers with zero rates pay none of the costs of benefits. Maximum rates cap what an employer must pay. For example, an employer who might otherwise pay a rate of 10 percent might have its rate capped at 5.4 percent.

The amount of taxable wages are capped. In most States, these caps are between \$7,000 and \$12,000 of the wages paid to each employee. In some States taxable wages exceed \$20,000. The lower the taxable wage base, the more low-wage employers or employers with high turnover pay the pooled costs discussed above.

While some State funding mechanisms respond quickly to economic changes, others are more sluggish. For example, given the same set of economic circumstances during a downturn, fund balances may drop drastically in one State because high tax rates do not come into effect, while in the other State the balance drops only moderately.

It should be noted that not all employers participate in this financing system in the same way. Certain nonprofit and governmental employers who are exempt from the Federal unemployment tax, but who are required to be covered under State laws, can opt out of State UI taxes by reimbursing the State for most or all (depending on State law) benefits paid to their former employees. While these employers are for the most part self-financing for the costs of benefits paid to their workers, they do not pay a share of any pooled benefits costs or administrative costs.

Finally, the employers who finance the system are concerned with the burden of filing multiple forms for multiple programs. The Department of Labor has participated with the Social Security Administration and the Treasury Department by establishing the Simplified Tax and Wage Reporting System project. This project has initiated a number of pilots to streamline tax filing at both the Federal and State levels. The project is also examining the differences in definitions of

“employee” and “employment,” but no proposals for greater harmonization of these definitions have been put forward.

Financing Administration. This Dialogue Issue deals with how well the current system for administrative funding of the UI and ES programs works and other administrative issues. To what extent does the current financing system respond to workload changes over the business cycle? To what extent does it encourage efficient and cost-effective operations? Following is information on the current situation.

The current UI administrative financing system is based on data from work measurement studies conducted in the late 1970s through the mid-1980s, which have not since been updated. Complex formulas use these data and workload information to determine the resources needed to process a given set of workloads and pay overhead costs. The budget process requires projecting costs many months before the funds are made available and economic conditions are known. The final congressional appropriation is distributed to the States with any adjustments necessary. For unexpected workload increases within a fiscal year, additional funds are made available without further congressional action. However, this does not address the fundamental underfunding of the system in recent years.

Federal administrative costs are financed from Federal UI taxes through the Department of Labor's program administration budget for Federal UI, ES, veterans employment service, and labor market information activities. (This information on the labor market is developed through cooperative surveys by the Bureau of Labor Statistics with the States.)

While UI benefits are classified on the mandatory side of the domestic budget, both Federal and State administrative costs are classified on the discretionary side under the Budget Enforcement Act. Thus, although Federal and State laws require that every worker who files a claim for UI be served, there is no guarantee of administrative funds to finance the handling of that claim. Efforts have been underway for many years to reform UI administrative financing, and concerns have been expressed about the adequacy of the funding of ES.

Federal-State Relationship. This Dialogue Issue deals with how well the current Federal-State partnership works in assuring a basic national program that reflects differences among the States. It encourages discussion of broader issues: are there any changes needed in the division of responsibilities, such as in financing, benefit structure, or oversight? What should be the relationship between UI and ES? What form should ES take in the future? How should ES “return on investment” be determined? Following is information on the current situation.

Responsibility for administering the UI program is shared by the Federal and State governments. The major Federal responsibility is to ensure that a nationwide UI program is available to workers and employers in order to achieve the program's mission. Exactly how the program achieves the mission primarily has been a State statutory and administrative responsibility. This principle of shared responsibility is firmly established by the Social Security Act and the Federal

Unemployment Tax Act, which provide the framework for the Federal-State partnership. These Acts set forth coverage requirements, some benefit requirements, the Federal wage base and tax rate, and administrative requirements.

The UI program has recently adopted many technological innovations. Claims are taken and other administrative activities are performed remotely by telephone or through Internet access in many States. As a result, local offices are being consolidated, reduced or closed in many locations. Tax operations, too, have been automated and consolidated, reducing costs and improving employer services and access.

UI program measurement and evaluation have been accomplished through a series of reports States are required to submit to the Federal partner and through a series of evaluations and appraisals of program performance. Results of these assessments form the basis of annual State Program and Budget Plans, which constitute the basic grant agreement between the State grantee and Federal grantor for operation of the UI program.

Similarly, the ES program is a major part of the Federal-State One-Stop system. The Wagner-Peyser Act provides broad program requirements for the States to follow if they wish to receive Federal funding. Services are provided at no cost to workers. Over the years, the ES has also seen major changes. Job openings and resumes are available on the Internet on America's Job Bank and America's Talent Bank. The array of activities provided by the ES has broadened from placing workers in new jobs to providing assistance in helping workers find the jobs themselves.

How the UI and ES programs are linked has long been a matter of debate. The Department of Labor has recently focused on developing a workforce development system which, in its simplest form, means the worker could visit only one office (the One-Stop) to receive all UI, ES, and job training services.

Summary and Conclusion

As Secretary of Labor Alexis Herman noted in her March 13, 1998 address to a joint meeting of the Interstate Conference of Employment Security Agencies, the National Employers' Council and the National Association of Government Labor Officials:

Since UI was enacted in 1935, the economy has changed, the workforce has changed, the workplace has changed, the way we work has changed, and employers' needs have changed. We need to make sure that the economic programs we are responsible for, like UI, keep up with these changes.

The ways we respond to the issues will determine the course of the UI and ES programs for the 21st century. Will they live up to the high expectations which their history has established? Your thoughts and responses to the issues raised herein will help ensure that the programs continue to perform well.

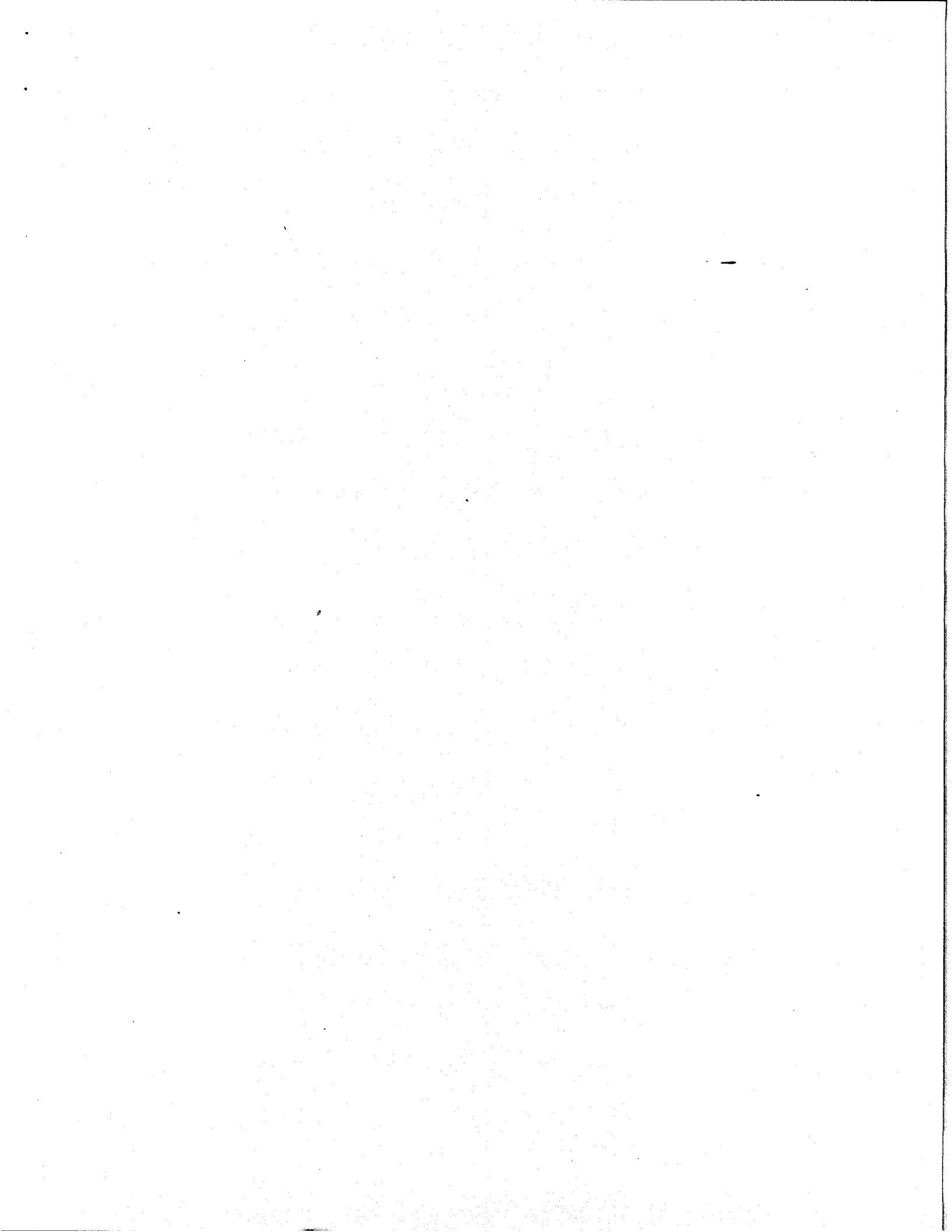
This paper provides a framework for the Dialogue that will proceed for the next year. Representatives from the Department of Labor will be making speeches and presentations and conducting forums for discussion of these and other related issues. You should check the Department's Internet Web Page at www.dol.gov or www.doleta.gov for announcements of these opportunities.

Comments

The purpose of this Dialogue paper is to stimulate discussion and debate over the UI and ES programs and their ability to provide an effective safety net for the unemployed while promoting transition to reemployment. We do not intend the discussion to be limited to the issues raised above, and we welcome the views of all interested parties on the issues raised in this Dialogue paper as well as on other issues not discussed here. Your responses will help guide the overall dialogue and possibly highlight areas in which the Department needs additional information collection and research.

Responses received within sixty days after formal issuance (approximately August 12, 1998) will help the Department as it begins to develop its part of the fiscal year 2000 President's Budget. However, the dialogue will be on-going for the next year or so, because these are complex issues.

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- Mail to: U.S. Department of Labor
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ATTACHMENT

Dialogue Technical Supplement

Dialogue Technical Supplement

Section I CURRENT ENVIRONMENT

Macroeconomic Forces and Demographic Factors
Effects on the Workforce
Effects on the UI and ES Programs
Performance Considerations

Section II UI PROGRAM MISSION AND PRINCIPLES

UI Program Mission
UI Program Principles

Section III AVAILABILITY OF BENEFITS

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Section V ADDITIONAL INFORMATION ON THE UI PROGRAM

The Federal Tax Credit Scheme
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Section VI UI ADMINISTRATIVE FINANCING

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Allocating the Appropriation to the States

Section VII The Employment Service and Other Programs

Endnotes

Dialogue Technical Supplement

This Technical Supplement discusses aspects of the current Unemployment Insurance (UI) and Employment Service (ES) programs in more detail. It covers the same basic areas as the Dialogue paper, but is arranged differently for economy of presentation.

I. CURRENT ENVIRONMENT

Macroeconomic Forces and Demographic Factors.

Three major macroeconomic forces are shaping our economy and our workforce: technological change, increasing global competition and changing demographics. Since these changes affect the nature of work and jobs, it is appropriate to study these changes to determine if they also affect the operation and impact of the UI and ES programs

Technological Changes. Rapid changes to production processes and the rapid creation of new products and services create new jobs and entirely new industries, eliminating other jobs and altering established industries. For example, between 1976 and 1997, employment in computer services grew by 268 percent while manufacturing employment declined by 1.3 percent. The demand for high skilled workers has increased, while the demand for low-skilled and unskilled workers has decreased.

Globalization. One of the most profound changes has been the emergence of a global economy. Economic activity is not location driven but rather is distributed and adaptive to local conditions.¹ Businesses now customize products and services for clients all over the world, communicate rapidly and directly with suppliers, distributors, and customers, and engage in a variety of collaborative ventures with other organizations at a distance. Lower communication and transportation costs bring markets closer together. For the workforce, this means more jobs related to foreign trade. For example, in 1969, fewer than 4 percent of all U.S. manufacturing workers held export-related jobs. That share had jumped to 18.6 percent by 1991.²

Demographics. A number of demographic factors affect the workforce.

Aging Workforce. Over the next 55 years, the population over 65 years old will double. According to the Census Bureau, the future age structure of the population will be older. The median age will steadily increase from 34.0 in 1994 to 35.5 in 2000, peak at 39.1 in 2035 and then decrease slightly to 39.0 by 2050.

The Bureau of Labor Statistics (BLS) predicts that the fastest growing segment of the workforce will be those 55 and over, expected to increase by 43.8 percent from 1996 to 2006. In 2006, the over 55 and older age group will make up 15 percent of the labor force compared to 13.7 percent in 1982.

Continued High Participation Rates for Women. The number of women in the workforce has been rising. Women currently account for 46 percent of the workforce and, in the years ahead, they will approach parity with men.³ According to BLS data, the percent of women participating in the labor force nearly doubled from 33 percent to 60 percent between 1948 and 1997. Between 1996 and 2006, women are expected to account for nearly three-fourths of the labor force growth. There has been an increase in the number of mothers with young children who now hold jobs; approximately 64 percent of all married women with children under six years of age are in the workforce today compared to only 18.6 percent in 1960.⁴ The increasing

rate of women in the workforce indicates that "getting ahead" may depend increasingly on dual incomes, but reflects many other factors as well.

Immigration. According to one estimate, under current law, immigration could increase the American population by 70 million between 1990 and 2040. This would represent almost 2/3 of the net population growth expected to take place.⁵ The foreign born population accounted for 9.7 percent of the U.S. workforce in 1994, up from only 6.4 percent as recently as 1980.⁶ Immigration is expected to be the chief cause of population growth in the decades ahead.⁷

Effects on the Workforce.

The possible effects of economic change on the workforce include workforce shifts, a growing service economy, the changing nature of jobs, the changing nature of work, changing work patterns for workers and families, and possible worker anxiety.

Workforce Shifts. The workforce has shifted geographically over time, in part to follow jobs. In recent years, population growth has occurred in the Mountain and Pacific areas at a rate nearly twice the national average, while the East, North Central and Middle Atlantic States show very little growth.⁸ Shifts to areas where UI claims rates have traditionally been low may have contributed to a reduction in the percentage of workers receiving UI.⁹

Service Economy. Over the past 20 years, the trend has been a decline in the number of manufacturing jobs (although that trend has recently been reversed) and an increase in the number of jobs in the service sector. Since 1970, over 24 million service jobs have been created, while manufacturing has lost 833 thousand.¹⁰ Also, of the almost 560 thousand manufacturing workers displaced between 1993 and 1994, only half were reemployed in this industry when surveyed in February 1996. By comparison, nearly three-fourths of the over 36 thousand losing jobs in the expanding and diverse service industry were reemployed in the same industry. Roughly one in four workers losing jobs in the manufacturing, transportation and public utilities, retail trade, and finance, insurance, and real estate sectors had found new jobs in the service sector when surveyed in February 1996.¹¹

Nature of Jobs. Workers are expected (and often choose) to change jobs more often than ever before. The growing frequency of job shifts and career changes is evident when examined across segments of the population. For example, the median job tenure within ten-year age brackets drops for men of all ages; while those of ages 55-64 saw their job tenure fall from 15.3 to 10.5 years between 1983 and 1996.¹² This pattern has implications for both workers and employers. Workers will have to continually upgrade their skills to maintain their attractiveness to employers, while employers will have to adopt policies to attract and maintain a trained labor supply.

In addition, while traditional work relationships will continue to comprise the majority of the workforce, the number of non-standard employment relationships will continue to grow. Non-standard employment is defined as part-time employment, temporary employment, employment as independent contractors, and leased employment. Competitiveness, flexibility, and the need to attract workers will drive these non-standard relationships from the employer side. On the worker side, older workers moving in and out of the labor force and the continuing rate of growth of two-income families will drive the trend.

Nature of Work. Globalization and technological innovations are rapidly changing the nature of work and workplaces in America. Many firms are using the services of contingent workers and are making other alternative work arrangements to reduce costs. For example, between 65-85 percent of companies have some part-time workers. Data from BLS' February

1997 Current Population Survey Supplement indicate that there were 23.9 million part-time workers, 10.3 million self-employed workers, 8.5 million independent contractors, 2.0 million on-call workers and 0.8 million leased workers. According to one survey, most businesses foresee an increase in the use of workers from temporary help agencies, short-term hires, part-time workers, on-call workers and contract workers in the next five years.¹³

Effects on the UI and ES Programs

Over time, the cumulative effects of the macroeconomic forces have brought about changes in the characteristics of the unemployed. When the UI program was established in 1935, it was intended to pay workers who were temporarily laid off and were expected to return to their previous jobs after a short spell of unemployment. Changes in the labor market--for example, long-term unemployment, geographic shifts, non-standard employment relationships--have produced a different claimant population. These changes have resulted in claimants who no longer return to their previous jobs or even their previous industry, more claimants in the services industry and less in manufacturing, more claimants who eventually exhaust benefits and who may be in need of more intensive reemployment services, claimants who are older, and more claimants who are women. Workers who have to find work in a new industry tend to stay unemployed for longer periods than those who can stay within the same sector.¹⁴

In the early days of the UI program, a considerable majority of UI claimants were men. In 1996, 56 percent of UI claimants were male and 41 percent were female, with 3 percent not reporting. In terms of racial breakout 62.8 percent were White, not Hispanic; 14.1 percent were Black, not Hispanic; 13.7 percent were Hispanic; 5 percent were other; and 4.4 percent were not identified. In 1996, 79.8 percent of UI claimants were less than 55 years of age. From 1988 to 1997, the average age of UI claimants rose from 38.2 to 40.1, corresponding with the rise in the average age of job losers from 34.9 to 37.1. The greatest increase was among professionals, which increased from 39.9 in 1988 to 42.1 in 1997.¹⁵ About 77 percent of UI claimants earned less than \$25,000 in 1996, with 48 percent with earnings below the poverty level for a family of five.¹⁶ This Dialogue will determine whether these changes also warrant changes in the UI and ES programs.

Performance Considerations

Any discussions concerning the UI and ES programs must examine whether they are effectively accomplishing their objectives and whether these are the proper objectives for the new economy. In broad terms, Congress established its views on the importance of measuring program effectiveness when it passed the Government Performance and Results Act of 1994. This Act requires Federal agencies to devise strategic and performance plans and to report to Congress on program performance. Congress will use this material to determine program effectiveness and, potentially, program funding. Because the ES and the administrative costs of the UI program are funded through congressional appropriations, annual program performance and outcome information are important.

II. UI PROGRAM MISSION AND PRINCIPLES

The UI program was established by the Social Security Act (SSA) in 1935. In 1939, its provisions related to tax credits were moved to the Federal Unemployment Tax Act (FUTA). Since its inception the UI program has made over 340 million first payments.

UI Program Mission

In 1955, the Department of Labor described the UI program as follows:

Unemployment insurance is a program--established under Federal and State law--for income maintenance during periods of involuntary unemployment due to lack of work, which provides partial compensation for wage loss as a matter of right, with dignity and dispatch, to eligible individuals. It helps to maintain purchasing power and to stabilize the economy. It helps to prevent the dispersal of the employers' trained work force, the sacrifice of skills, and the breakdown of labor standards during temporary unemployment.¹⁷

This statement probably remains the best description of the mission of the UI program: Its objectives are to alleviate the hardships that result from the loss of wage income during unemployment, stabilize the economy at both the local and national levels, and preserve an employer's workforce.¹⁸ The UI program is the nation's largest worker protection program for job loss. As an insurance program, it is not means-tested and is available for all eligible workers.

The UI program functions as an automatic economic stabilizer by maintaining consumption during economic downturns. In its final report to the President in 1996, the Advisory Council on Unemployment Compensation (ACUC) reaffirmed this objective of promoting economic stability by maintaining consumer purchasing power during downturns.¹⁹

UI Program Principles

Many of the UI program's basic principles are evident from the program's mission and many are based on insurance principles. Some of the basic principles are outlined below.

Benefit Payment Principles

1. Unemployed workers with previous work experience should generally receive benefits if they become unemployed through no fault of their own.
2. Benefits must be payable in sufficient quantity to provide reasonable purchasing power while maintaining incentive to work and taking into account costs of financing the benefits. Operationally, this has been interpreted to mean that the workers should receive sufficient benefits to reasonably meet living expenses for a period of time sufficient to find suitable work.

These principles are evident when the program's mission is considered. Although they do not often come into play, two other principles are worth noting: UI may not be used to force workers to accept substandard working conditions as an alternative to losing UI, and UI should remain neutral in certain union matters. As a result, workers may not be denied benefits for refusing work where they are required to join or not join a labor organization.

Benefit Funding Principles

1. System is Self-Financing. According to the Senate Committee Report for the 1935 Social Security Act, a concept "essential in unemployment compensation is the creation of reserves during periods of employment from which compensation is paid to workmen who lose their positions when employment slackens and cannot find other work." From a revenue standpoint, the program takes in more money from the economy when it can afford it and less when the economy is less able to afford it. From a benefit payment standpoint, the program pays fewer benefits when the economy is healthy and more benefits when the economy is weak.

2. Pooled risk. Following this private insurance principle, employers share risk by contributing to a common fund that pays out benefits to unemployed workers. Pooled risk is attractive because the individual employer does not pay the full cost of the event insured against when it occurs (that is, the full cost of unemployment). It also assures payments will continue for workers even if the employer goes out of business.

Pooled risk for benefits also exists at the Federal level. The Federal unemployment tax funds two accounts in the Unemployment Trust Fund from which benefits are paid. The Extended Unemployment Compensation Account partially funds benefits paid during periods of high unemployment. These funds are disbursed to States based on levels of unemployment and regardless of amounts paid in by the State employers. The Federal Unemployment Account is used for advances (that is, loans) to States with insolvent funds. Funds from this account are also disbursed regardless of amounts paid by employers within a State or a State's previous history of receiving advances.

3. Experience Rating. While some costs of unemployment may be pooled, others are equitably allocated among employers using experience rating. The balance between experience rating and pooling is a matter of State choice.

Generally, each private-sector employer has an account which is charged with benefits paid to its former workers. The more payments to unemployed workers, the higher the employer's tax rate. However, in the event the employer goes out of business or in the event the unemployment is not caused by the employer (for example, a voluntary quit which can result in benefit payments in many States) or if the employer experiences unusually high benefit charges, the risk is pooled.

Experience rating also contributes to economic stabilization since employers take into account the costs of unemployment before laying off workers. Experience rating also involves employers in the eligibility process. For example, if a worker who quits without good cause claims benefits, the employer will likely object to the payment of benefits since the employer would otherwise be liable for the costs.

Administrative Principles

1. Shared Federal and State Responsibilities. Responsibilities for the UI program are shared by the Federal and State governments.

In recommending the creation of the Federal-State system, President Roosevelt's Committee on Economic Security recommended that the "States shall have broad freedom to set up the type of unemployment compensation system they wish. We believe that all matters in which uniformity is not absolutely essential should be left to the States."²⁰ More recently, the ACUC seemed to

affirm this basic premise when it stated that the program needs to pursue two courses of action simultaneously: (a) foster the inherent advantages that accrue from assigning significant responsibility to the States, and (b) seek to minimize or prevent the emergence of phenomena that may threaten essential national interests.²¹ Although debate on the proper division of responsibilities continues, the principle of a Federal-State system seems firmly established.

2. Pooled Risk. Risk is pooled nationally for administrative financing. States that need more administrative funds than are collected from employers in the State through FUTA in a given year receive more and those that need less receive less. The pooling of administrative funding was designed to ensure that States would not be placed in an adverse competitive relationship with each other because of differing UI administrative costs caused by such factors as geography, population, size and claims workloads caused by seasonal or cyclical patterns.

3. Access to Reemployment and Related Services. The UI program is linked with other programs to assist the worker in finding new employment. Federal UI law requires that "all compensation be paid through public employment offices or such other agencies as the Secretary of Labor might approve." This plainly means that UI claimants are to be offered employment services. The Wagner-Peyser Act specifically identifies UI claimants as a group to be provided with "job finding and placement services".²² In addition, other programs, such as those under the Job Training Partnership Act, provide training to facilitate a return to employment. The Worker Profiling and Reemployment Services program was developed to strengthen the link between UI claimants and reemployment and related services. Not only does assisting the worker in finding new employment help the worker, but also it preserves the solvency of the State's fund and helps reduce employer costs.

III. AVAILABILITY OF BENEFITS

Basic Concepts and Brief Background

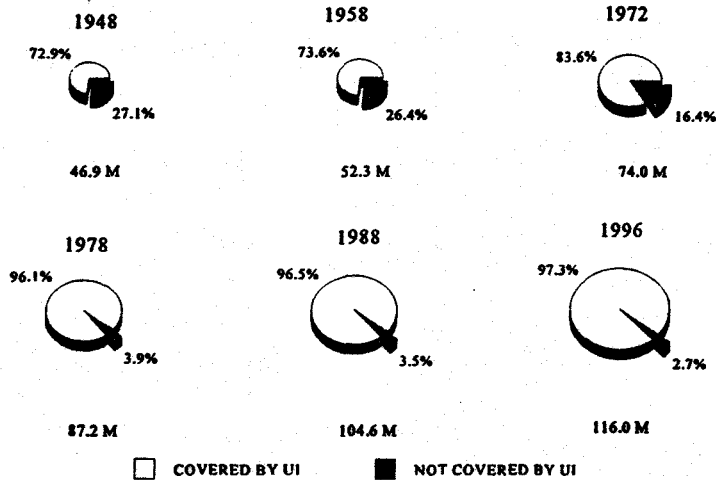
Coverage. "Coverage" refers to services performed which are subject to taxes or dollar for dollar reimbursable payments from the employer. Covered services are insured against the risk of unemployment. Workers losing covered jobs may be entitled to benefits if otherwise eligible.

The trend has historically been toward expanded coverage (see Figure 1). In 1935, only workers for private businesses employing eight or more workers were covered. By 1970, only the smallest employers were not covered. Special "Federal" programs were added in the 1940s and 1950s to provide coverage to former military and Federal employees. Coverage was extended to most services performed for State and local governments and nonprofit organizations by 1978. Originally, an estimated 73 percent of wage and salary workers were covered. An estimated 97 percent of wage and salary workers are currently covered (see Figure 2). The largest excluded class of workers is the self-employed, including "independent contractors" who do not work as employees for any employer. Others usually not covered are agricultural workers on small farms, workers for small nonprofit organizations, and workers in church-operated entities such as religious schools.

HISTORY OF COVERAGE EXPANSIONS	
1935	Employers of 8 or more
1939	Minor exclusions and additions
1944	First temporary UI program for veterans (as Part of the GI Bill of Rights)
1952	Second temporary UI program for veterans (UCV)
1954	Employers of 4 or more
1954	UI for former Federal employees (UCFE)
1958	Permanent program of UI for exservicemembers (UCX)
1970	Employment Security Amendments of 1970 Coverage for employers of one or more workers, and certain nonprofit and governmental entities; U.S. citizens working outside the U.S. for American firms; mandated a single Combined Wage Claim system
1976	UC Amendments of 1976 Extension of coverage for nonprofit and governmental entities Coverage for agricultural employers with 10 or more during 20 weeks or \$20,000 in a quarter Domestic service over \$1,000 per year

Figure 1

Unemployment Insurance Coverage of Wage and Salary Employment

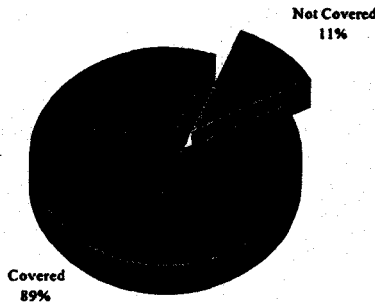


Prepared by: USDOL/ETA/UIS/DFAS

Figure 2

Instead of using wage and salary workers as a measure of coverage, the civilian labor force may be used. During 1996, on average, about 89 percent of the civilian labor force were either working in covered employment or collecting UI benefits (see Figure 2a). The other 11 percent were unemployed new entrants, unemployed re-entrants, job leavers, UI exhaustees, job losers who did not apply for UI, the self-employed (including independent contractors), and UI ineligible such as part-time workers seeking part-time work and workers not satisfying the monetary requirements.

UI and the Civilian Labor Force CY 1996



Prepared by: USDOL/ETA/UIS/DFAS

Figure 2a

Since Federal law determines the minimum requirements for coverage, the Federal partner has been the main force behind extending coverage throughout the years. States have always, however, been free to cover more services. Conversely, while States may exclude some services which are not excluded under Federal law, the employer loses the Federal offset credit against the "uncovered" services. (The offset credit is discussed in Section IV.) Because of this, only a few services are excluded in this way.

Entitlement. A worker must have sufficient attachment to the workforce to qualify for UI. This is usually determined by requiring the worker to have a minimum amount of earnings in covered employment.

States have great latitude in establishing entitlement requirements. Most use wages earned by an employee in covered employment during a one-year period, known as the "base period." In most States, a worker's base period is the first four of the last five completed calendar quarters immediately preceding the filing of a claim for benefits. Generally, States require that the worker have earnings from covered employment totaling \$1,000 to \$3,000 in one calendar quarter within the base period, and many require additional earnings in another calendar quarter of the base period. One result of such base periods is that wages earned in the most recent quarter(s), known as the "lag" quarter(s), are not used to compute the worker's entitlement to benefits. In other words, the worker's most recent work history is not taken into account which tends to reduce entitlement for UI, particularly for new entrants and re-entrants to the labor market who tend to earn low wages.

Eight States have eliminated this lag quarter by using an alternative base period that allows the use of recently earned wages when computing benefit entitlement for those who are initially found to be ineligible.

Some States have limitations concerning "seasonal employment." Under this limitation, a worker can use wages earned in seasonal employment only if the unemployment occurs during the season. Although the assumption is that the worker is not available for work outside the season, many workers may have taken seasonal work only because it was the only work available. The number of States with seasonal restrictions has fallen from a high of 33 States in the early years of the program to 15 today.

The Federal government's interest in testing previous attachment to the workforce has been limited to a few specific instances. One Federal law provision prohibits a worker from establishing two claims based on one period of employment. Under another Federal law provision, workers who may not otherwise be entitled to benefits are able to combine employment and wages earned in two or more States into one claim.

In 1966, Congress considered "benefit standards" which would have set minimum levels of earnings for entitlement. Although different versions passed both houses of Congress, no statute was enacted.

Sufficiency. Sufficiency relates to whether the amount of benefits is adequate to meet the worker's minimum needs for getting through a period of unemployment, taking into account the incentive to return to work. Most States replace, on average, half or less of lost pre-tax wages. For example, a worker making \$300 before taxes will receive a UI benefit of \$150 before taxes. All States cap the amount of benefits they will pay for a week. The lowest cap is \$180 and the highest (without dependents allowances) is \$390. The highest with dependents allowances is \$573. (States using dependents allowances determine the amount of UI payable by

taking into account how many individuals are dependent on the worker. Most do not take into account dependents.)

Generally, severance pay, accrued vacation and sick leave cause a reduction in the UI weekly benefit amount. All States deduct any earnings a worker might have from weekly benefit amounts, although the specific formula for doing so varies from State to State. If a worker holds two jobs and loses one, the earnings from the second job will cause a reduction in the weekly benefit amount.

Generally, the area of benefit levels is left to the States. One Federal requirement in this area is that receipt of a pension which is 100 percent contributed to by a base period employer must result in a dollar-for-dollar reduction in the UI weekly benefit. Also, UI benefits are subject to Federal income tax, although they are not subject to payroll taxes.

Duration. Duration is the number of weeks UI benefits are available. While the UI program is intended to replace lost wages for only a temporary period of time, the "appropriate" duration varies with economic conditions, with additional weeks required in severe economic downturns when job-finding becomes more difficult.

When the UI program began, maximum durations were short, in part because of uncertainty about the financial viability of the program. In 1950, 13 States paid a maximum duration of 26 weeks of benefits; the rest paid fewer. By 1960, 42 States paid at least 26 weeks, and 9 of these States paid more than 26 weeks. By 1970, 51 States paid 26 weeks and 10 of these States paid more than 26 weeks. In the early 1980s, many States stopped paying beyond 26 weeks. Currently, all States pay at least 26 weeks and two pay more than 26 weeks.

During economic downturns, regular benefits exhaustions rise significantly. A permanent Federal-State Extended Benefit (EB) program, in existence since 1970, provides for up to 13 additional weeks (or 20 additional weeks in States which have adopted an optional trigger). States must pay EB if the percent of workers collecting UI rises above a certain level. (States have the option of paying EB if the total unemployment rate is above a certain level.)

In response to economic downturns, special emergency benefit programs were created in 1958, 1961, 1972, 1975, 1982 and 1992 (see Figure 3). Two of these preceded the EB program, three supplemented it, and one essentially replaced it when Congress felt EB was not adequately responding during a downturn. Aside from the first extension, all benefit costs were borne by the Federal government. In four of these instances, the Federal costs were paid from FUTA revenues.

HISTORY OF EXTENSIONS	
1958 - 59	Temporary Unemployment Compensation - 13 additional weeks. States were loaned money to pay benefits; repaid through a FUTA increase.
1961 - 62	Temporary Extended Unemployment Compensation - 13 additional weeks - 100% Federally funded; paid for by increased FUTA tax.
1970 - present	Extended Benefits (EB). A 1966 bill had EB in it, but EB was not enacted until 1970. Used State Insured Unemployment Rate (TUR) and, until 1980, National Trigger. Optional Total Unemployment Rate (TUR) since early '90s. Funded by 50% State and 50% Federal (FUTA) dollars.

HISTORY OF EXTENSIONS	
1972 - 73	Emergency Unemployment Compensation Act of 1971 - 13 weeks if EB was exhausted - 100% Federally (FUTA) funded.
1975 - 78	Special Unemployment Assistance - for people who had no benefit rights. Before coverage of State and Local governments. Funded with Federal General Revenue.
1975 - 78	Federal Supplemental Benefits - additional 13/26 weeks for EB exhaustees - 100% Federally funded from FUTA and General Revenue.
1982 - 86	Federal Supplemental Compensation - additional weeks of benefits; used a tiered IUR to establish duration - 100% Federally funded with General Revenue.
1992 - 94	Emergency Unemployment Compensation - up to 33 weeks - used IUR and TUR triggers. 100% Federally funded from FUTA and General Revenue.

Figure 3

Eligibility. After a worker establishes prior workforce attachment, continued attachment to the labor market must be demonstrated to show that the unemployment is "involuntary."

The basic Federal requirement for eligibility is that the worker be able to work and available to accept an offer of work. Most other eligibility conditions are left to the States. To retain the insurance character of the program, States tend to disqualify individuals who leave jobs without good cause, commit misconduct connected to the work, or refuse suitable work. These disqualifications tend to be "duration" disqualifications, which means the worker is disqualified until returning to work for a given period of time. Earlier, some of these disqualifications were for set periods, for example, 13 weeks. The philosophy behind these "set" disqualifications is that after the disqualification period, the worker's unemployment is not due to the circumstances of the disqualification, but instead due to general economic conditions. In 1970, 27 States had duration disqualifications for voluntarily leaving employment and the remainder had "set" disqualifications. However, by 1995, 50 States had duration disqualifications. (For UI purposes, there are 53 "States," including the District of Columbia, Puerto Rico and the Virgin Islands.)

Eligibility requirements vary among States. For example, some States pay workers who leave work with certain types of "good cause" not attributable to the employer while others do not. As a result, workers who quit to accompany their spouses to a new job are eligible to receive UI in some States while other States disqualify these workers. Also, some States pay workers who previously worked part-time and continue to seek only part-time work, while others pay them only if they are seeking full-time work.

Although eligibility requirements are largely left to States, some Federal law requirements exist (see Figure 4). Some of these serve to deny benefits. Thus, certain aliens may not be eligible, certain athletes may not be paid between athletic seasons, certain teachers may not be paid between academic terms, and workers must be denied if they do not report to services to which they have been referred through the Worker Profiling and Reemployment Services program. Other Federal requirements serve to allow benefits. For example, workers may not be denied because they are in approved training, have refused substandard work, or reside in or have filed from another State.

HISTORY OF BENEFIT STANDARDS (ELIGIBILITY PROVISIONS)	
1935	UC cannot be denied because of union status and conditions of work
1970	<u>Employment Security Amendments of 1970</u> Between terms denial for teachers Double dip - prohibits 2 benefit years based on 1 period of employment Equal treatment for interstate claimants Combined-wages claims system Approved training Cannot totally reduce benefits except as specified (e.g. misconduct, fraud)
1976	<u>Employment Security Amendments of 1976</u> Pregnancy disqualification prohibited Athletes between seasons Aliens - use of base period services Pension deduction
1980	<u>Omnibus Reconciliation Act of 1980</u> Sustained and systematic search for work for EB eligibility Work requalification required for EB
1981	<u>Omnibus Budget Reconciliation Act of 1981</u> 20 weeks of work or equivalent to qualify for EB
1992	<u>Emergency Unemployment Compensation Act of 1992</u> Suspension of 1980 and 1981 EB requirements for duration of this emergency program
1993	<u>UC Amendments of 1993</u> Profiling - Those identified as likely to exhaust UI and in need of job search assistance are referred to reemployment services

Figure 4

Finally, since 1981, States have been required to apply special eligibility provisions to receive Federal dollars for EB and other emergency benefit programs. Rigorous work search and suitability of work provisions exist as do several other requirements. These provisions were, however, suspended for the emergency program created in 1992.

In two cases, Federal law created special benefit programs to provide for greater flexibility in fostering workers' economic adjustment. The first is "short-time compensation" or work sharing, under which the employer may, in lieu of laying off some workers, reduce the work-week for all workers. All workers may then receive UI for the period of unemployment. For example, workers could work four days a week and receive UI at one-fifth their weekly benefit rate for the fifth day. Currently, 17 States have work sharing provisions in their laws. The second is "self-employment assistance" (SEA). A worker may elect to receive SEA payments to help establish a new business in lieu of UI benefit payments, provided the worker is working in self-employment under the guidance of a State economic development agency. Ten States have SEA laws, although not all have implemented them. The program is scheduled to expire in December 1998 and this limitation may have affected States decisions in enacting and implementing SEA programs. Neither work sharing nor SEA programs are widely used in States authorizing them.

Performance: Reciprocity Rates, Benefit Sufficiency and Economic Stabilization

Are the workers who need benefits receiving them? Are benefits sufficient to help workers through periods of unemployment and to serve as an economic stabilizer?

Reciprocity Rate. The traditional indicator of the extent to which the UI program provides benefits to unemployed workers and helps stabilize the economy is the "reciprocity rate." The reciprocity rate is the ratio of the insured unemployed (those claiming benefits (excluding claims under extensions such as EB)) to the total unemployed (all unemployed workers seeking employment). In the 1950s, the reciprocity rate averaged 49 percent. However, this figure has eroded over time until, during the 1990s, the average has been about 35 percent (see Figure 5). Among States, there is a wide range of reciprocity rates. For 1997, the highest State had a 59.3 percent reciprocity rate and the lowest had a 19.2 percent rate. Although these figures may reflect local economic conditions for any given year, many States have maintained consistently high or low reciprocity rates.

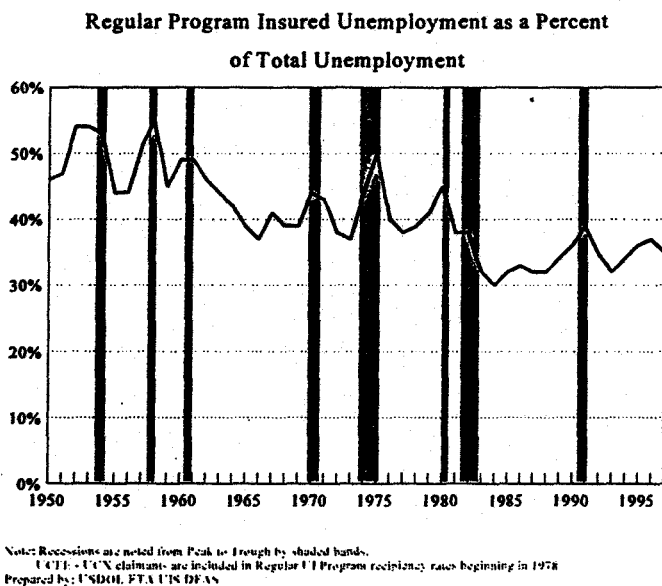
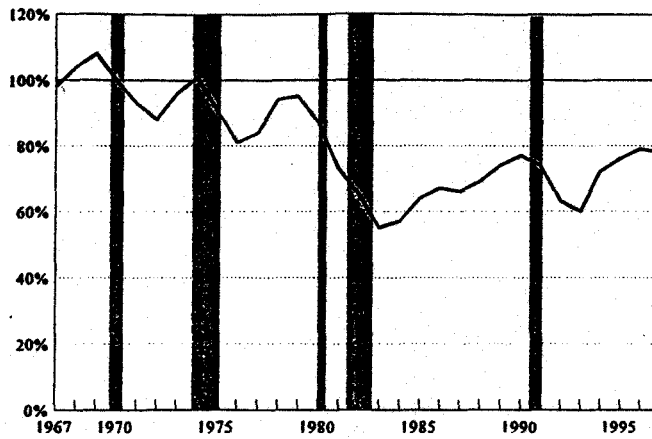


Figure 5

Another measure is the ratio of UI recipients to job losers. In the 1970s, this ratio was 91 percent and in the 1990s the ratio is 71 percent (see Figure 5a). In some cases, this ratio may exceed 100 percent. This is a result of different data sources for job losers (the Current Population Survey) and insured unemployment (weekly records of claims activity), paying benefits to some job leavers and re-entrants, and the fact insured unemployment includes those workers who have not lost their jobs, but are eligible for UI because their work weeks have been reduced to the extent that they qualify for UI. The data by State for both reciprocity measures is shown in Figure 6.

Regular Program Insured Unemployment as a Percent
of Total Job Losers



Note: Recessions are noted from Peak to Trough by shaded bands.
UCFE - UCX claimants are included in Regular UI Program reciprocity rates beginning in 1978.

Figure 5a

Reciprocity Rates
CY 1997

	Using Total Unemployed	Using Job Losers			
Alabama	27.8	74.1	Montana	37.1	81.9
Alaska	49.9	100.5	Nebraska	30.6	92.0
Arizona	21.4	57.1	Nevada	48.6	108.6
Arkansas	44.5	109.0	New Hampshire	20.3	44.6
California	39.1	80.6	New Jersey	45.0	84.2
Colorado	27.6	79.7	New Mexico	23.9	57.2
Connecticut	39.0	81.7	New York	33.9	71.9
Delaware	40.4	81.5	North Carolina	35.0	77.7
Dist. of Columbia	42.9	98.1	North Dakota	48.4	109.9
Florida	24.0	54.3	Ohio	29.3	66.6
Georgia	21.6	52.8	Oklahoma	19.4	53.5
Hawaii	36.7	82.3	Oregon	41.6	85.2
Idaho	38.4	79.4	Pennsylvania	48.1	97.3
Illinois	40.6	84.6	Puerto Rico	32.1	INA
Indiana	29.2	65.9	Rhode Island	59.3	115.0
Iowa	37.4	100.9	South Carolina	29.5	81.0
Kansas	28.0	88.9	South Dakota	21.1	53.1
Kentucky	26.9	63.8	Tennessee	30.2	61.8
Louisiana	19.5	21.0	Texas	22.3	54.6
Maine	36.5	71.9	Utah	27.6	80.3
Maryland	27.3	64.3	Vermont	51.8	109.6
Massachusetts	49.3	94.0	Virginia	19.2	50.3
Michigan	43.3	91.4	Virgin Islands	INA	INA
Minnesota	40.1	82.1	Washington	52.8	116.3
Mississippi	28.0	72.4	West Virginia	31.0	76.6
Missouri	33.9	89.0	Wisconsin	49.4	100.3
			Wyoming	27.4	66.6
			United States	35.1	77.9

Figure 6

Whichever measure is used, the trend is downward. Research cites several reasons for the decline.²³ While some studies find the change in reciprocity to be due to the change in the take-up rate—that is, the percentage of workers who file for UI—others cite more restrictive eligibility requirements. As discussed above, duration disqualifications are now more common and only two States now pay benefits beyond 26 weeks. Another example is increasing the length of work required for eligibility, raising the qualifying wage requirements and increasing penalties for termination due to misconduct, voluntary quitting, and refusal of suitable work.

Many of the eligibility restrictions enacted in the 1980s were related to State actions to improve solvency. During and following the 1980-82 recessions, 33 States needed to borrow from the Federal government, signaling a re-examination of the balance between taxes and benefits. At the same time, borrowing became more expensive as Congress established interest charges in 1982 and allowed the existing FUTA repayment mechanism to go into effect. (This mechanism incrementally increases the FUTA rate in borrowing States, starting the second year after the initial advance, until the advance is repaid.) Congress gave further financial incentives to raise taxes and cut benefits by rewarding States which took actions to improve solvency with interest reductions and deferrals. The Department of Labor subsequently issued guidance on solvency improvement, which included advice on eligibility reduction. Many States responded to these various pressures and incentives by, among other things, tightening eligibility requirements, which in turn may have adversely impacted the reciprocity rate. These responses reflected trade-offs between the value of benefits to workers, including the determination of the appropriate measure of workforce attachment to qualify, and the costs to employers.

Other forces to reduce reciprocity were also at work. Research shows that some of the decline may be caused by the shift in unemployment from geographic areas with traditionally high reciprocity rates to areas with lower rates; reduced growth rates in industries that typically have high claims rates (mining, construction and manufacturing); and the decline in unionization where members tend to be more educated about their UI benefit rights. This last point is supported by the survey evidence collected in a supplement to the Current Population Survey during 1993 which found that about 36 percent of those job losers who did not file for UI either thought they were not eligible or were not aware of the UI program. (Twelve percent of all job losers do not file for UI.) It has also been suggested that taxation of UI benefits may have contributed to the decline. State UI agencies have also stated concerns that closing of local offices has caused declines in reciprocity, as has the granting of generous severance packages to some workers.

Changes in the labor market such as industry downsizing, global competition, and improved technology have all contributed to the problem of worker dislocation, that is, job loss resulting in a reduced likelihood that a worker will return to the same type of job in the same industry from which the worker was laid off. Dislocation results in longer durations of unemployment and exhaustion of benefits as affected workers have difficulty locating new employment often because of low demand for their skill sets. These exhaustions can contribute to declines in reciprocity rates as the dislocated workers no longer can collect UI but they remain unemployed.

In addition, over the long run, increased use of temporary and part-time workers and independent contractors has likely contributed to the decline in the reciprocity rate since these workers are less likely to qualify for UI benefits when they become unemployed.²⁴ Figure 7 displays the growth in part-time workers since 1968, when data were first collected. (The change between 1994 and 1995 reflects a change in the survey methodology.) In 1968, part-time workers represented less than 14 percent of total civilian employment but trended upward to over 18 percent in the early 1980s and has since remained around that level. Employment in the temporary help industry increased from 0.5 million in 1981 to about 2 million in 1996. While historical data on other

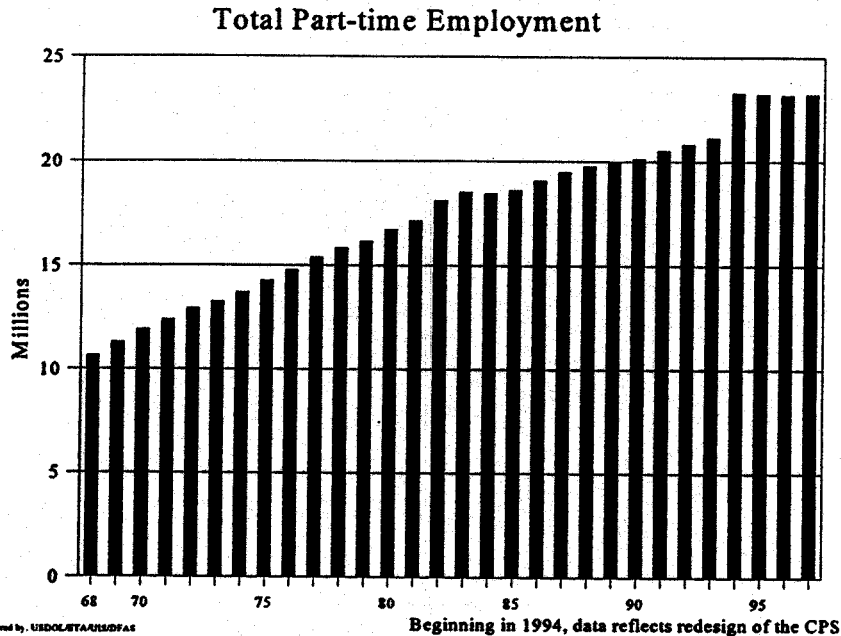


Figure 7

types of temporary workers and independent contractors are not available, anecdotal evidence from States indicates that the proportion of independent contractors is increasing.

Independent contractors are self-employed and are therefore excluded from coverage and temporary workers often fail to meet monetary requirements. Part-time workers are another matter. In many States, part-time workers are held ineligible if they seek only part-time work, even if they have a long history of part-time work. The number of workers working part-time for noneconomic reasons, that is, those working part-time because they only want part-time work and who are likely to seek part-time work should they become unemployed, has grown from around 9 million in 1968 to over 18 million in 1997 (see Figure 8. As with Figure 7, the change between 1994 and 1995 reflects a change in the survey methodology.) Clearly, there are employers who want part-time workers and there are workers who want part-time work. While such workers may not be eligible for UI benefits, employers pay UI taxes for part-time as well as temporary workers (although the incidence of these taxes is uncertain). At the same time, any proposal to make such workers eligible must take into account the incentives for employers to hire them.

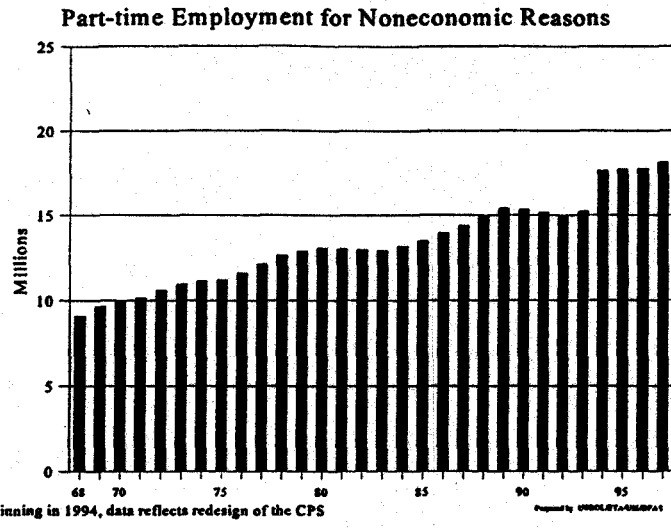


Figure 8

Benefit Sufficiency. Measuring the sufficiency of benefits is difficult. Judgments must be made concerning what proportion of lost earnings should be replaced to provide for a worker's living expenses. Should they be limited only to "nondeferrable" expenses? Should these include expenditures such as housing debt, transportation and health care? Should members of the household be taken into account?²⁵ Most States' benefit formulas are designed to replace about 50 percent of a worker's wage up to a maximum benefit. Depending on where the maximum benefit is set, many workers receive less than 50 percent wage replacement.

The adequate level of UI benefits has long been the subject of debate. Some argue that the current level of benefits and durations are too generous, while others argue they are not generous enough.²⁶ Both sides have attempted to measure the drop in consumption spending that occurs during periods of unemployment. However, this is a difficult area to measure since this drop is also a function of the amount of assistance workers receive from other sources such as spouses, relatives and savings.

A measure of benefit sufficiency is the "replacement rate." One method of computing the replacement rate is to divide claimants' weekly benefit amounts by their hourly wages times 40 hours per week. For calendar year 1997, the national average replacement rate was 47.0 percent. The highest replacement rate was 57.3 percent and the lowest was 32.2 percent (see Figure 9).²⁷

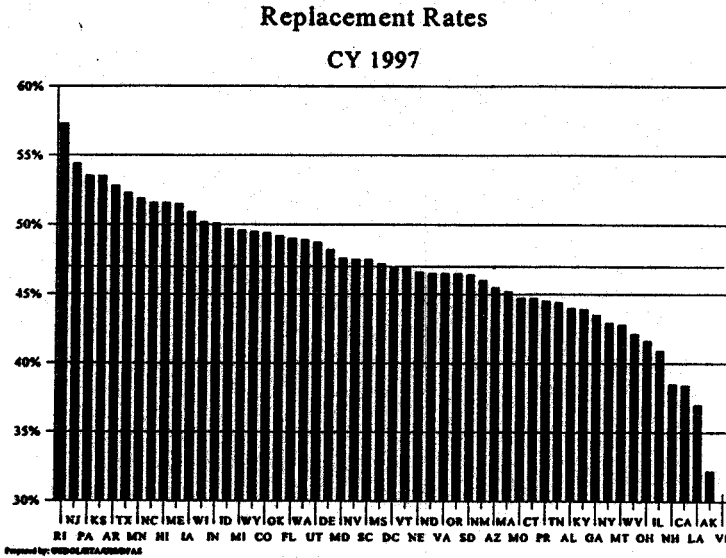


Figure 9

To some extent this may reflect the variation in maximum benefit amounts among the States. For example, the lowest maximum weekly benefit amount in any of the 53 jurisdictions is \$180. The highest ranges from \$390 to \$573 depending on whether the worker is receiving dependents allowances. Figure 10 presents a graph of maximum and minimum weekly benefit amounts.

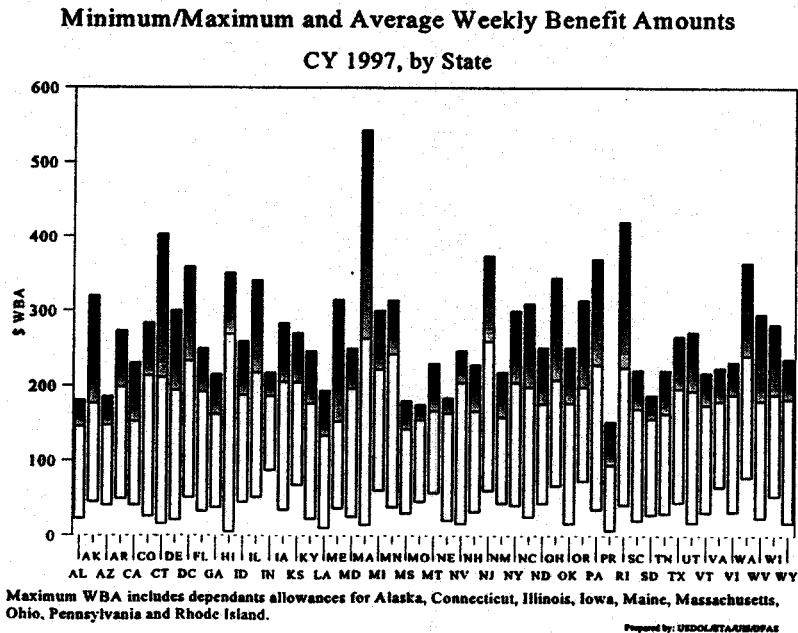


Figure 10

Economic Stabilizer. In addition to serving to stabilize a worker's income, the UI program also serves as an economic stabilizer, smoothing the business cycle and improving the efficiency of the economy. This is largely achieved through increased UI benefit payments during recessions while UI tax collections remain stable or fall. During downturns, a high level of benefit payments maintains purchasing power and tends to support economic activity. This stabilization effect is determined by the net injection of money into the economy, that is, the extent by which UI benefits paid exceed UI taxes collected. During economic expansions, the program has the opposite effect as taxes collected exceed benefits paid having the tendency to reduce inflationary pressure.

After implementation of the UI program in 1938 and the transition to a post-war economy in the late 1940s, recessions were less frequent, generally of shorter duration, and less severe. Figure 11 shows the percent of change in gross national product, with the shaded areas defining recessionary periods. It also reflects the volatility experienced by the economy. This more stable economy helped create an environment in which businesses could grow and prosper and provide Americans with an increasing volume and variety of goods and services. Although a number of factors, including fiscal and monetary policy, contributed to the economic stability reflected in the chart after 1950 and the impact of UI is very difficult to measure, the UI program is widely recognized as a key fiscal factor.

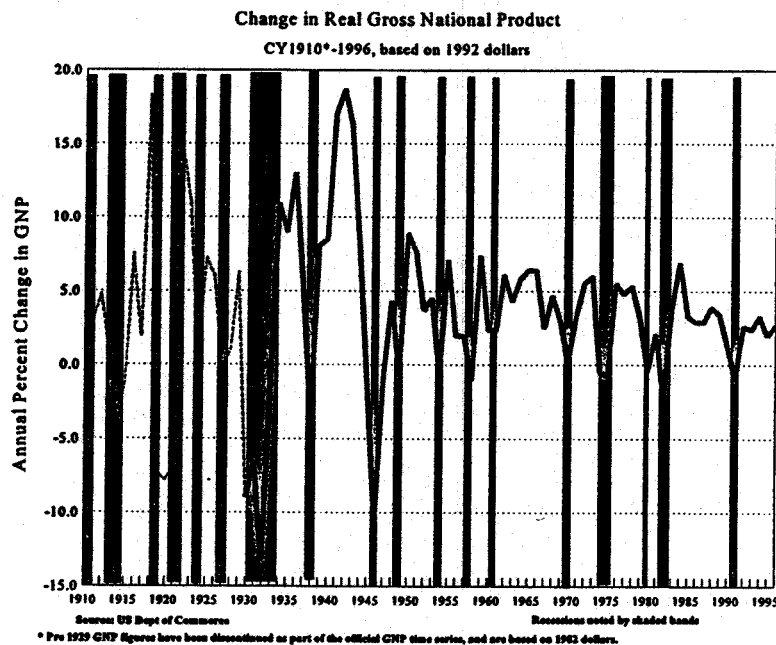


Figure 11

Measuring the stabilizing effect of UI involves substantial methodological challenges. Some studies have indicated that the UI program's effectiveness as an economic stabilizer has declined over time, but it is not clear how well these studies have dealt with some of the basic assessment problems this issue poses.²⁸ The Department of Labor is supporting further research in this area, which may shed additional light on the subject.

How well the UI program serves as a macroeconomic stabilizer depends, to a large extent, on how well it provides individual economic assistance and the breadth of that assistance. The lower the proportion of involuntarily unemployed workers receiving UI benefits to help meet

expenses, the lower the ability of the program to stabilize the local or national economy. Similarly, since the UI payment itself affects purchasing power, its adequacy also affects overall stabilization.

The corresponding impact of higher employer liabilities on economic stabilization needs to be given equal consideration. Who actually bears the burden of the UI tax—the economic incidence—has not been established. Economists agree that the amount of the tax, if any, shifted to employees through lower wages or shifted to consumers in the form of higher prices, depends on several factors, including the degree of competition in the labor and product markets.²⁹

Increasing the UI program's stabilizing effect means increased payments and, of course, funding those payments. The following section discusses financing UI benefits.

IV. BENEFIT FUNDING

Maintenance of Adequate Reserves

The maintenance of adequate trust fund reserves is key to the mission of economic stabilization. When its balances are depleted during an economic downturn, a State faces choices: (1) raise taxes, (2) restrict benefit availability, (3) reduce benefit amounts and/or (4) borrow. When implemented during a recession, the first three actions thwart economic stabilization. While borrowing may delay the need for these three actions, the experience has been that States have taken these actions to avoid or repay loans.

The issue of adequate reserves, sometimes referred to as "forward funding," involves decisions about the size of the reserves and the responsiveness of the tax system to changes in fund balances. There is no universally agreed upon "best" definition of adequate reserves. Fund balance by itself is a misleading measure since it does not reflect a State's UI law or economy. Although the Department of Labor believes the best way to assess fund solvency is to use a statistical model to simulate a variety of future situations, not all States use such a model, so national comparisons cannot be made using this approach. This leaves us with the static measures discussed below.

The high cost multiple (HCM) was developed by the Interstate Conference of Employment Security Agencies' (ICESA's) Benefit Financing Committee in 1959. It divides the reserve ratio (the balance of the fund as a percent of total covered wages) by the highest historical annual cost rate (the "cost rate" is benefits as a percent of total covered wages). The HCM tells us the number of years that a State could pay benefits, without additional revenues, at a rate equal to its highest historical payout rate. The Committee recommended States maintain trust fund balances that resulted in HCMs of between 1.5 and 3.0.

The HCM shows the "worst case" threat to fund solvency. Another measure, the Average High Cost Multiple (AHCM), shows a less severe, "bad case" threat. The AHCM is the reserve ratio divided by the average high cost rate, which is the average of the highest three annual cost rates in the last 20 years or over the last three business cycles (whichever is longer). The AHCM tells us the number of years a State could pay benefits, without additional revenues, at a rate equal to the average of its worst three recent years and provides an indicator of the likelihood of borrowing in an economic downturn. A comparison of pre-recession AHCMs with State borrowing patterns provides a rough indicator of the probability of borrowing in a particular type of recession.

Figure 12 categorizes States by their AHCMs at the start of the last four recessions (the recessions of 1980-83 are combined) and by their borrowing. In the deep recessions of the mid-1970s and early 1980s, almost every State with an AHCM less than 1.0 was forced to borrow. Experience was mixed for States between 1.0 and 1.5. Most, but not all, States above 1.5 were able to avoid borrowing. Because the 1990s recession was relatively mild, no State above 1.0 needed to borrow. The ACUC recommended that States maintain trust funds with enough reserves to pay for at least one year of benefits at this level.³⁰ The last column of the chart shows the distribution of AHCMs for 1997. Figure 13 gives a breakout by State of AHCMs for 1989 and 1997 and reveals that on a national basis, State trust funds are in a weaker position than in 1989.

Average High Cost Multiple vs. Actual Borrowing

Average High Cost Multiple	1971-76			1980-84*			1990-92			Dec-1997**
	# of States	# of Loans	% Loans	# of States	# of Loans	% Loans	# of States	# of Loans	% Loans	# of States
≥ 2.0	12	2	17%	3	0	0	3	0	0	6
1.75-1.99	8	1	13%	0	0	0	4	0	0	4
1.50-1.74	5	1	20%	5	1	20%	7	0	0	5
1.25-1.49	5	2	40%	8	2	25%	9	0	0	7
1.0-1.24	7	2	29%	10	6	60%	10	0	0	10
.75-.99	5	5	100%	5	3	60%	8	1	13%	6
.50-.74	6	6	100%	6	6	100%	7	2	29%	11
< .50	4	4	100%	16	15	94%	5	3	60%	4
TOTAL	53	24***	45%	53	33	62%	53	6	11%	53

* This period includes both recessions of 1980 and 1981-82.

** Wages for this period are estimates because actual wages were not yet available.

*** The AHCM for Virgin Islands could not be calculated for this period, but Virgin Islands did borrow.

Note: Pre-recession average high cost multiples are calculated for December 1973, December 1979, and December 1989.

Note: Highlighted cells under the time periods indicate the location of the median State.

Figure 12

Average High Cost Multiples
Comparison of 1989 vs 1997

State	1989 AHCM	1997 AHCM	diff
Alabama	1.47	0.81	-0.66
Alaska	1.12	0.98	-0.14
Arizona	1.18	1.70	0.52
Arkansas	0.52	0.63	0.11
California	1.05	0.70	-0.35
Colorado	0.83	1.11	0.28
Connecticut	0.24	0.75	0.51
Delaware	1.58	2.17	0.59
Dist. of Columbia	0.42	0.71	0.29
Florida	1.82	1.89	0.07
Georgia	1.37	2.22	0.85
Hawaii	1.92	1.21	-0.71
Idaho	1.82	1.26	-0.56
Illinois	0.54	0.50	-0.04
Indiana	1.18	1.58	0.40
Iowa	1.50	1.33	-0.17
Kansas	1.71	1.41	-0.30
Kentucky	0.83	0.76	-0.07
Louisiana	0.49	1.30	0.81
Maine	1.09	0.70	-0.39
Maryland	0.96	0.97	0.01
Massachusetts	0.58	0.94	0.36
Michigan	0.15	0.65	0.50
Minnesota	0.56	0.59	0.03
Mississippi	1.96	1.88	-0.08
Missouri	0.63	0.58	-0.05
Montana	1.02	1.24	0.22
Nebraska	1.15	1.39	0.24
Nevada	1.45	1.06	-0.39
New Hampshire	1.42	2.30	0.88
New Jersey	1.32	1.13	-0.19
New Mexico	1.70	2.58	0.88
New York	0.93	0.31	-0.62
North Carolina	1.67	1.27	-0.40
North Dakota	0.77	0.39	-0.38
Ohio	0.38	0.63	0.25
Oklahoma	1.39	1.87	0.48
Oregon	1.63	1.24	-0.39
Pennsylvania	0.60	0.65	0.05
Rhode Island	1.24	0.61	-0.63
South Carolina	0.90	1.37	0.47
South Dakota	1.60	1.01	-0.59
Tennessee	1.09	1.04	-0.05
Texas	0.79	0.33	-0.46
Utah	1.44	1.84	0.40
Vermont	2.07	2.43	0.36
Virginia	1.49	1.61	0.12
Washington	1.27	1.02	-0.25
West Virginia	0.51	0.43	-0.08
Wisconsin	1.18	1.16	-0.02
Wyoming	0.84	1.67	0.83
US Average	1.02	0.94	-0.08

Source: USDOL/ETA/UIS/DFAS

Figure 13

Using the ratio of the fund balance to total covered wages as a measure, the aggregate solvency of the State funds has shown a downward trend over time as shown in Figure 14, reflecting a weakened financial position. In 1950, State fund balances represented 6.8 percent of total covered wages. In 1997, they stood at only 1.5 percent of wages which results in an AHCM of .94. In between, there have been cyclical ups-and-downs. Since the 1990-91 recession, balances have increased very slowly. However, by the end of 1997, the balances had not yet reached the pre-recession level of 2.4 percent of wages which results in an AHCM of 1.5.

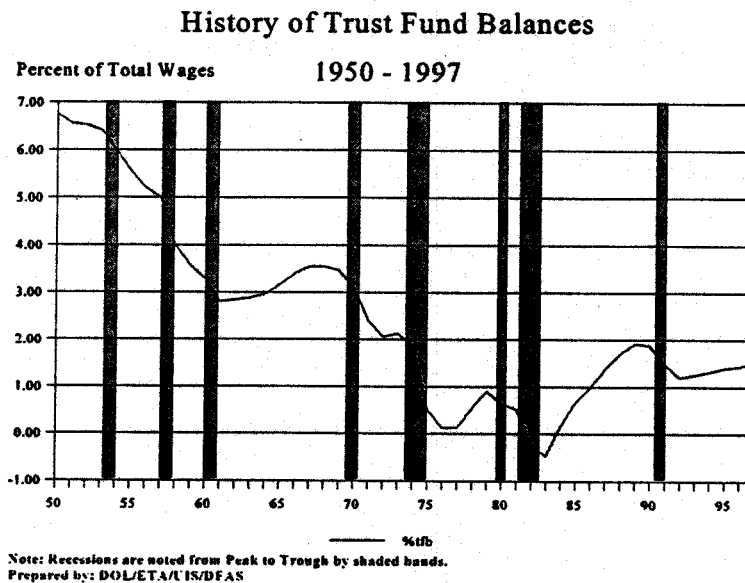


Figure 14

No matter what yardstick is used, the status of some State funds is a source of concern. The ACUC concluded that a "coherent federal strategy that includes congressionally stated goals" was needed and that "financial incentives to encourage forward funding should be created." This conclusion was based on the belief that "economic stabilization, which transcends the interests of States, cannot be achieved by States working in isolation."³¹ Of the 18 States that have reduced taxes since 1992, four currently have AHCMs below 1.0.

Based on current solvency positions and historical outlay and revenue patterns, it is estimated that 25 - 30 States would have to borrow \$20 - \$25 billion if a recession of the magnitude of the 1980-82 recessions were to occur in the near future. For a milder recession similar to the 1990s, 8-12 States are projected to borrow \$2 - \$4 billion. Interest on these loans would accrue. Since interest on loans was implemented in 1982, States have paid more than \$1.7 billion in interest, mostly through increased employer taxes. As indicated previously, the question of forward-funding is one of the issues being raised in this Dialogue.

Experience Rating

Currently, there are a number of different ways of measuring employers' experience with unemployment. Most of these use benefits paid to an employer's unemployed workers as the measure of unemployment experience.

Experience rating has three main goals:

- (1) Equitably allocating the costs of unemployment benefits among the employers;
- (2) Encouraging employers to "police" the program by raising issues, when warranted, to assure proper determinations of eligibility; and
- (3) Encouraging employers to stabilize employment by making them pay costs of unemployment.

Experience Rating vs. Pooled Costs. Although experience rating is intended to equitably allocate the costs of unemployment, it should be recognized that no system is perfectly experience rated; some costs are pooled (or "socialized" or "mutualized") among all employers in the State. This occurs because employers go out of business, because some States measure experience for only three years (which allows an employer to eventually escape "bad" experience), and because benefits are frequently "noncharged." Noncharging occurs when the employer cannot be reasonably held accountable for the worker's unemployment. For example, in some States, if a worker is found eligible after quitting employment for good personal cause such as following a spouse, the worker's employer is not "charged" if benefits are paid.

Another factor affecting experience rating is the State's maximum tax rate. Tax rates are capped to prevent placing greater financial burden on employers in economic difficulty. The higher the maximum, the greater proportion of benefits are being covered by employers with "poor" experience. Similarly, the lower the minimum rate, the lesser is the subsidy from minimum-rated employers to the rest of the program. Finally, increasing the number of tax rates or reducing the interval between those rates contributes to experience rating by increasing the likelihood that small increases in layoffs will result in immediate tax increases. Large intervals between rates have the effect of reducing the measurement of "relative experience." That is, employers with quite different experience could still be assigned the same rate because the State has few tax rates. For example, States that assign zero rates to substantial numbers of employers with varying experience tend not to have a high degree of experience rating. In general, employers that are below the maximum State tax rate will eventually pay for their benefit costs in nominal terms, but how quickly they do so affects their real costs.

The effect of the taxable wage base is closely linked to other elements of experience rating. However, all other things being equal, higher and/or indexed taxable wage bases promote experience rating because, for example, they reduce the likelihood that employers will reach the maximum rate. Twelve States currently have a taxable base of \$7,000. Forty-one States have higher taxable wage bases up to \$26,400.

A final factor which affects the degree of experience rating is the method used by States to assign benefit charges when the worker has more than one recent employer. In most States, benefits are charged to base period employers in proportion to earnings.

As a result of the many variables in States' taxable wage bases and rates, benefit formulas, and economic conditions, actual tax rates vary greatly among the States and among individual employers within a State. For the latest year available (1997), the preliminary estimated U.S.

average tax rate is 0.8 percent of total wages, with State averages ranging from a high of 2.1 percent to a low of 0.2 percent.

Effectiveness of Experience Rating. Has experience rating been effective in accomplishing its objectives? The first question is the extent to which costs have been allocated to employers. This has been a matter of debate. Studies on the allocation of costs have shown that the amount of subsidization of certain employers is substantial, that the largest subsidies go to seasonal and high-turnover industries, and that subsidies for individual employers tend to persist over time.

The second question is the effect of experience rating on employer "policing" of the program. Because of the effect on their tax rates, employers tend to review claims which might be charged to them. Although there has been little formal study of this aspect, it is generally accepted that participation can help keep an employer's rate low and the benefit fund solvent while probably enhancing program integrity. However, this aspect is also criticized as many believe it encourages employers to focus solely on the issue of costs of individual claims and not the benefits of macroeconomic stabilization, and because some employers may raise frivolous objections in hopes of reducing their UI costs.

The third question is whether experience rating encourages employers to stabilize employment. Although studies have not demonstrated the extent to which experience rating does so, it has generally been accepted that it has this positive effect and that more "perfect" experience rating should cause fewer layoffs.³² (All of the studies were constrained by data limitations.) Obviously, employers already paying the maximum rate do not face increased taxes when layoffs are made (even though they may face paying the maximum rate for a longer period), thus reducing the incentive to stabilize employment. A related point is the extent to which the employer who actually laid off the worker is liable for the benefit costs. When there is a "lag" period between the base period and the filing of the claim, the employer who laid off the worker may not be liable for any benefit costs. Instead, the employers who contributed to the base period wages will be liable for all costs. This may encourage "free" lay-offs in some cases.³³

Each year, the Department of Labor publishes the Experience Rating Index, which attempts to measure the degree of experience rating in a State. The index represents the proportion of total benefits which are paid for by the employer potentially chargeable for the benefits paid. Figure 15 shows the experience rating index by State for 1996, which is the latest year for which data are available. The median index number for 1996 was about 61 percent. In other words, 61 percent of benefits paid were paid for by the employer responsible for paying the unemployment benefits. The median has fluctuated around that level since the index was first computed in 1988.

EXPERIENCE RATING INDEX BY STATE
RATE YEAR 1996

STATE	IEC (000s)	IAC (000s)	NNC (000s)	BEN (000s)	ERI
Alabama	29,037	7,903	30,457	168,270	60
Alaska					N/a
Arizona	1,008	8,368	23,343	136,733	76
Arkansas	8,282	14,724	38,919	141,270	56
California	695,806	414,854	211,031	3,101,322	57
Colorado	50,565	13,541	7,782	164,593	56
Connecticut	80,239	10,384	67,838	448,187	65
Delaware	18	21,466	1,268	56,807	60
Dist. of Columbia	6,560	11,235	1,631	89,255	78
Florida	45,273	9,378	99,382	538,081	71
Georgia	15,211	21,079	14,011	247,951	80
Hawaii	50,770	17,628	30,907	178,867	44
Idaho	18,198	2,152	16,585	87,104	58
Illinois	71,114	12,682	97,243	1,050,368	83
Indiana	13,636	24,691	21,617	195,829	69
Iowa	14,741	8,519	19,256	143,882	70
Kansas*	81,788	10,677	23,685	137,984	16
Kentucky	33,564	12,308	11,628	193,859	70
Louisiana	225	12,205	25,364	133,325	72
Maine	15,911	2,643	24,022	101,863	58
Maryland					N/a
Massachusetts	138,081	48,457	256,227	884,258	50
Michigan	134,724	64,619	21,999	811,136	73
Minnesota	35,210	6,151	42,649	300,314	72
Mississippi	12,481	13,962	21,403	95,362	50
Missouri	26,706	1,941	59,231	280,492	69
Montana	7,341	5,155	6,074	46,920	60
Nebraska	5,437	3,850	12,032	42,882	50
Nevada	8,033	1,635	17,699	135,091	80
New Hampshire	1,225	2,319	1,412	30,414	84
New Jersey	289,678	103,698	33,488	1,199,504	64
New Mexico	7,139	4,180	12,128	63,707	63
New York	119,267	123,817	40,774	1,998,245	86
North Carolina *	181,666	30,812	72,472	309,139	8
North Dakota	5,326	1,553	3,252	26,797	62
Ohio	72,920	12,447	84,712	601,639	72
Oklahoma	19,148	10,391	17,182	95,352	51
Oregon	47,901	39,158	58,923	324,720	55
Pennsylvania	222,160	138,434	171,452	1,409,740	62
Puerto Rico					N/a
Rhode Island	25,339	10,653	14,052	164,505	70
South Carolina	17,602	14,557	36,666	159,696	57
South Dakota	3,230	993	2,183	12,926	50
Tennessee	1,708	63,305	28,156	252,109	63
Texas	154,355	88,747	178,490	933,964	55
Utah	452	4,201	10,511	55,202	73
Vermont	9,051	4,289	10,573	46,724	49
Virgin Islands					N/a
Virginia	8,917	12,613	18,439	191,024	79
Washington	95,667	89,805	235,217	837,792	50
West Virginia	24,565	18,429	6,871	123,365	60
Wisconsin	56,726	15,725	57,532	389,788	67
Wyoming	9,355	1,082	6,479	29,233	42

For NH, NJ, TN, and VT, ERI is for rate year ending June 30, 1997.

DE and OK are benefit-wage states. The numbers provided by these states are estimates.

* Kansas and North Carolina assigned a zero tax rate to all positive balance employers.

ERI = $(1 - ((IEC + IAC + NNC) / BEN)) * 100$, where IEC = ineffective charges (those charges not fully covered by employer taxes), IAC = inactive charges (charges to employers who have gone out of business), NNC = noncharges (payments made to claimants, but not charged to a particular employer), and BEN = total benefits paid.

Ineffective charges are the difference between benefit charges for the experience period and projected tax receipts for the current year for employers grouped by tax rate. This overestimates ineffective charges--and therefore underestimates the degree of experience rating--as it does not take into account benefits that may have been paid for in the past by positive balance employers or may be paid for in the future years. The Department is revising its reporting requirements to address this problem. Alternatively, a calculation could be made by excluding ineffective charges from the ERI.

Figure 15

V. ADDITIONAL INFORMATION ON THE UI PROGRAM

This section covers several areas related to the UI program. It explains the Federal tax credit scheme; the determination of the FUTA tax liability; and how the FUTA revenues are spent. It also discusses some Federal law requirements and how States deliver UI services.

The Federal Tax Credit Scheme

Conformity and Compliance. FUTA levies a Federal payroll tax of 6.2 percent on wages paid by employers. However, the rate is effectively reduced to 0.8 percent by credits which are available to employers. FUTA defines wages, compensation, employers, and employment for Federal law purposes. FUTA also contains the "conformity" and "compliance" requirements which a State must meet for employers in the State to receive credit against contributions paid into a State's unemployment fund. An additional credit is available if the State law meets FUTA's experience rating requirements. Finally, to receive administrative grants for the UI program, the State must meet the requirements found in Title III of the SSA.

Without approval (or "certification") by the Secretary of Labor, employers can not receive tax credits and the State cannot receive administrative grants. Since the certification process is the only formal process for Federal enforcement, most issues are handled informally. If the issue is not resolved informally, after notice and opportunity for hearing to the State, the Secretary may withhold the appropriate certification. Only a few conformity or compliance questions have resulted in a formal hearing. The State may appeal unfavorable decisions to the courts.

The severity of these actions have made Federal officials reluctant to apply them and State officials wary of doing anything that will result in their application. In the 1950s the Secretary of Labor asked the Department of Labor to study the possibility of providing for measures short of stopping grants or withholding tax credit. The Department was unable to suggest any lesser measure that the Secretary felt would be effective.³⁴

The enforcement process is time consuming. When proceedings are commenced, States are generally allowed to change their law and to correct the situation without employers losing credit or the State losing administrative grants. For example, if workers have been denied benefit payments inconsistent with Federal law, the State will change its law and retroactively pay them.

FUTA Computation. Assuming that the State in which the employer is operating has been certified by the Secretary of Labor, the FUTA tax is computed as follows:

The potential yearly tax liability is 6.2 percent on the first \$7,000 of wages paid to each worker ($\$7,000 \times 6.2 \text{ percent} = \434) or \$434. The FUTA tax credits available to employers are 5.4 percent on the first \$7,000 and amounts to \$ 378 ($\$7,000 \times 5.4 \text{ percent} = \378). With the FUTA credits, an employer's FUTA tax amounts to 0.8 percent ($6.2 \text{ percent} - 5.4 \text{ percent} = 0.8 \text{ percent}$) of the first \$7,000, or \$56 per employee. FUTA tax, credits and amounts collected are displayed in Figure 16. Most employers pay the FUTA tax. However, certain nonprofit and governmental entities do not pay this tax with the result they do not fund administrative costs. Also, the low wage base means that employers who pay lower salaries have disproportionate statutory responsibility for funding the program.

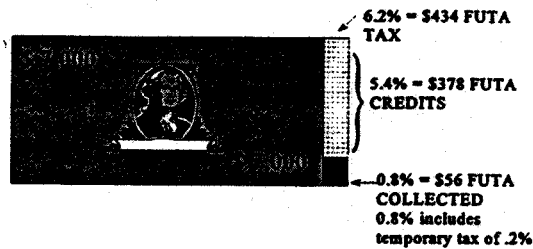


Figure 16

Federal Accounts and Fund Flows

State unemployment taxes are collected by each State and deposited to individual State accounts in the Federal Unemployment Trust Fund (UTF) where they are held in trust until withdrawn, with limited exceptions, for the payment of UI benefits. Also in the UTF are the following three Federal accounts:

- The Employment Security Administration Account (ESAA). This account retains 20 percent of FUTA revenues and funds the administrative costs of the UI program and related activities such as the ES, veterans employment, and labor market information programs.
- The Extended Unemployment Compensation Account (EUCA). This account receives 80 percent of FUTA revenues and pays 50 percent of EB payments. It has also been used to pay for temporary recession benefit programs.
- The Federal Unemployment Account (FUA). This account provides advances to States whose State benefit funds are depleted. States repay the advances, with interest, to FUA. It is funded from overflow from ESAA and EUCA when these accounts are at their statutory ceilings.

Each account has a statutory ceiling. For ESAA, the ceiling is 40 percent of the spending from the account in the current year. For EUCA and FUA, the ceilings may be thought of as the minimum amount Congress deems necessary to pay benefits during a recession. Both ceilings are expressed as percentages of total UI covered wages in taxable employment. Currently, the EUCA ceiling is 0.5 percent and the FUA ceiling is 0.25 percent. Figure 17 shows how these ceilings have fluctuated in the past and Figure 18 shows the Federal trust fund structure.

FEDERAL TRUST FUNDS

FUA CEILINGS	
Year Effective	Ceiling
1954	\$200,000,000
1960	Greater of \$550,000,000 or .4% of State Taxable Wages
1970	Greater of \$550,000,000 or .125% of State Taxable Wages
1988	Greater of \$550,000,000 or .625% of State Taxable Wages
1994	Greater of \$550,000,000 or .25% of State Taxable Wages
2002	Greater of \$550,000,000 or .5% of State Taxable Wages

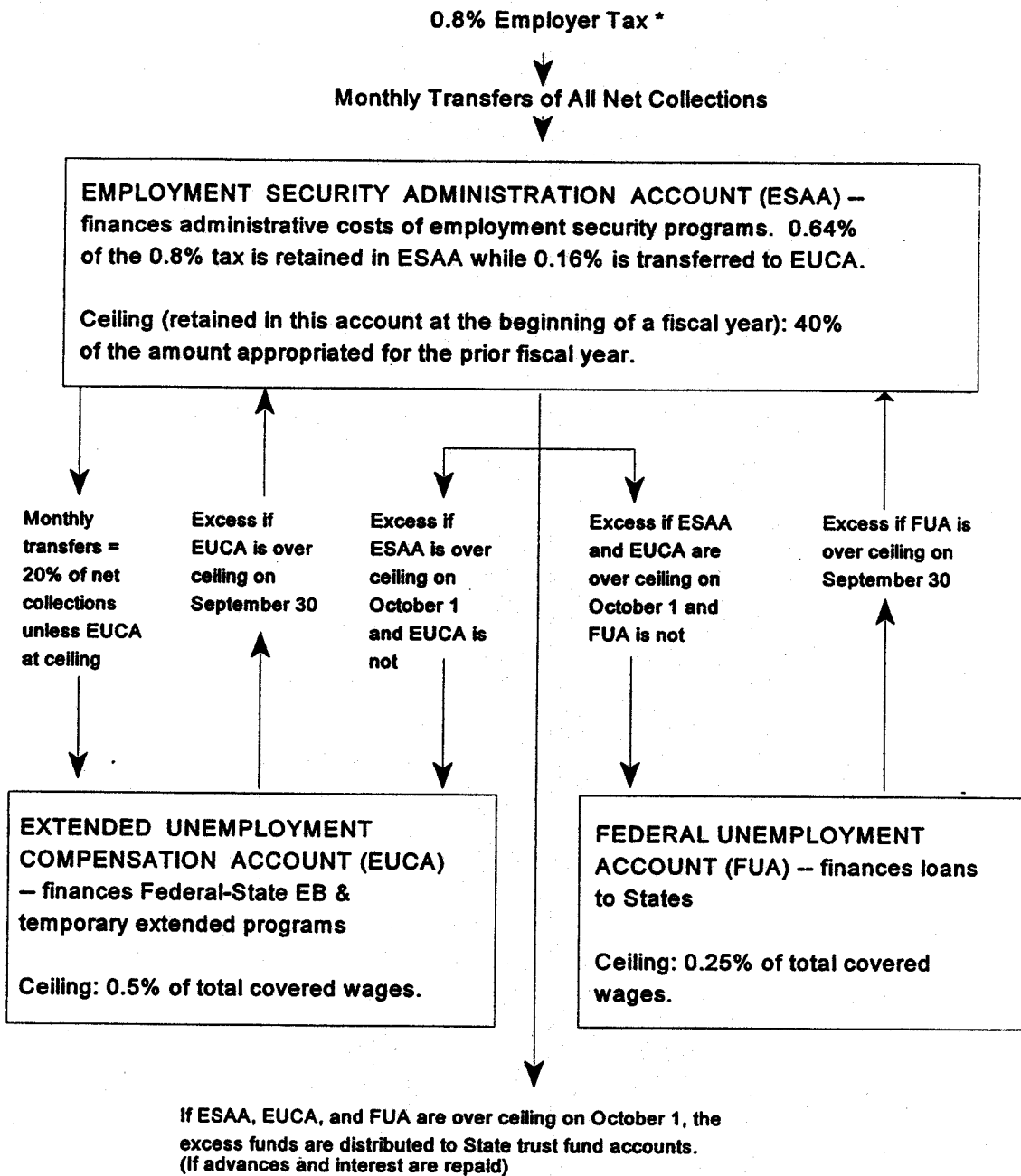
EUCA CEILINGS	
Year Effective	Ceiling
1970	Greater of \$750,000,000 or .125% of State Taxable Wages
1988	Greater of \$750,000,000 or .375% of State Taxable Wages
1994	Greater of \$750,000,000 or .5% of State Taxable Wages

Figure 17

When all three accounts reach their ceilings and all advances (with interest) have been repaid to FUA, the "excess" is distributed to State trust fund accounts in proportion to each State's FUTA taxable wages. This distribution is referred to as a "Reed Act" distribution. These funds have been used for UI and ES program administration as well as for paying UI benefits.

Like State trust fund accounts, the adequacy of the reserves in these accounts for handling any future downturns is an important issue. The historical balances in each fund are shown in Figures 19-21. Figure 22 shows current account balances and ceilings, as well as projected draw downs from each account in two hypothetical economic downturns similar to those in the 1980s and 1990s. It shows that both accounts are well-positioned to handle a mild recession, but are in a poor position if the recession is deep.

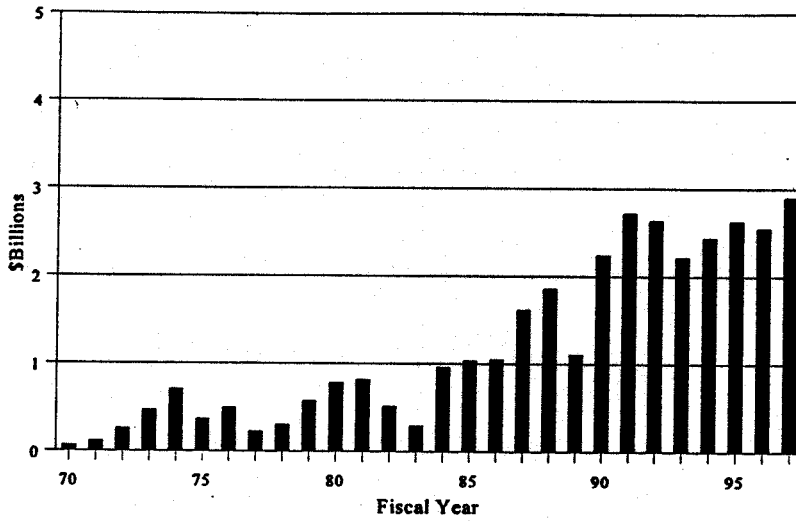
Flow of FUTA Funds



* Effective tax rate, after 5.4% is offset against 6.2% Federal unemployment tax.

Figure 18

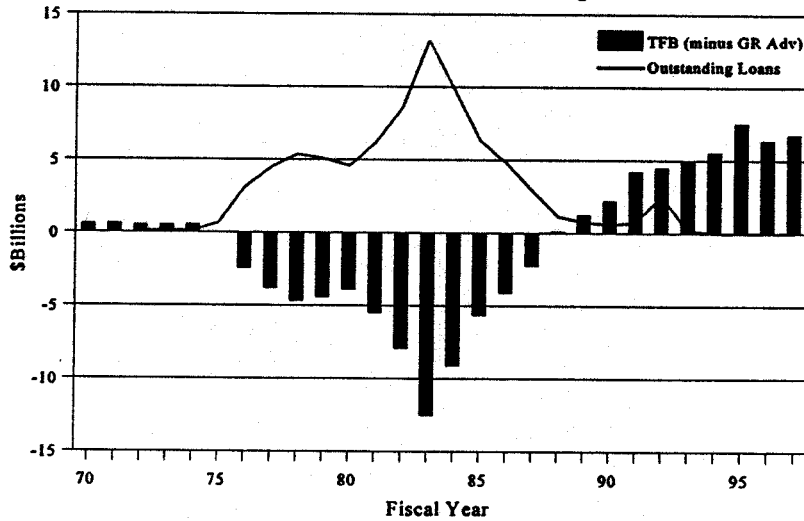
Employment Security Administration Account (ESAA)
Trust Fund Balance (prior to transfer of excess)



Prepared by: USDOL/ETA/USM/DFAS

Figure 19

Federal Unemployment Account (FUA)
TF Balance minus GR Advances, Outstanding Loans

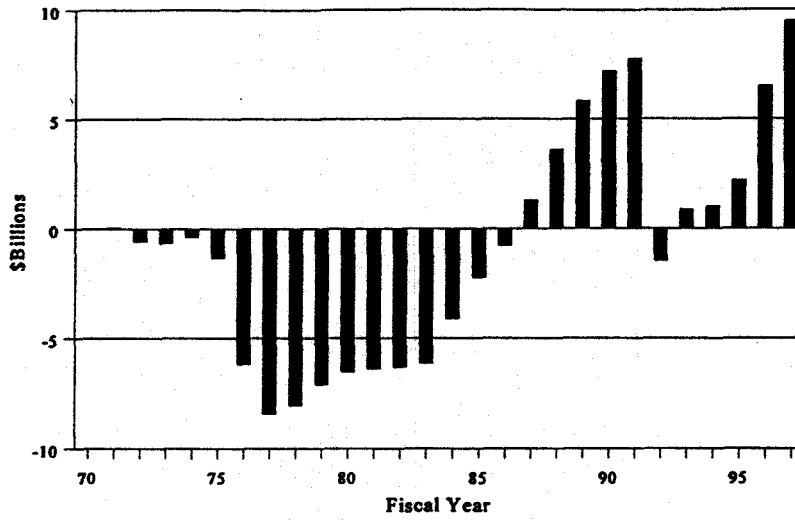


Prepared by: USDOL/ETA/USM/DFAS

Figure 20

Emergency Unemployment Compensation Account (EUCA)

Net Trust Fund Balance

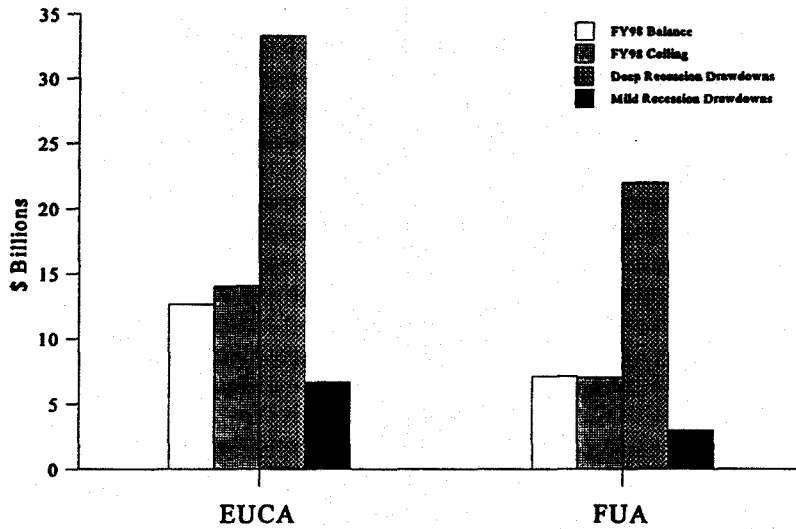


Prepared by: USDOLETA/USBRAS

Figure 21

Federal Unemployment Trust Funds

FY98 Balances vs. Potential Drawdowns



Note: EUCA outlays based on EB triggers proposed in UI Reform Legislation.
 In 1990's, \$28.5 B emergency program was funded from EUCA until account was insolvent.

Prepared by: USDOLETA/USBRAS

Figure 22

Federal Law Requirements Relating to Program and Administration

Federal Program Requirements. Original requirements included whether the worker has refused substandard work, the payment of benefits through public employment offices, immediate deposit to the U.S. Treasury of State UI tax revenues, and proper withdrawals from the State's unemployment fund. Over the years, requirements have been added. Some of these had clear national interests: treatment of interstate and combined-wage claims, expanded coverage, participation in the Federal-State EB program, and treatment of aliens. The national interest in others is not as clear: denial of athletes between seasons, denial of teachers between and within academic terms, and pension deductions. Other Federal requirements include the EB work search, income tax withholding, and disqualification for workers profiled as likely to exhaust benefits who fail to participate in reemployment services when these are offered. Changes in Federal program requirements affect the Federal budget deficit (see further discussion in Section VI).

Federal Administrative Requirements. In the beginning of the program, few Federal administrative requirements existed in law. Federal law required methods of administration as were found by the Secretary of Labor to be necessary for proper and efficient administration. These included methods for determining eligibility accurately and promptly, methods for collecting contributions and provisions for collecting contributions, provisions for enforcing these collections, provisions requiring employers to keep accurate records, provisions regarding the safeguarding of UI information, and standards for detecting and deterring overpayments.

In subsequent years, new administrative requirements have been imposed, such as maintaining wage records and providing information to various public agencies for various purposes, which are not always directly concerned with UI administration. Other Federal requirements include the Worker Profiling and Reemployment Services program through which States are required to profile workers to identify those who are likely to exhaust UI and need reemployment services. These workers are referred to any available services which facilitate their reemployment. States are required to intercept delinquent payments of child support from UI and to withhold Federal income tax from UI if the worker so elects. Departmental regulations require the States to operate quality control activities designed to measure the accuracy of benefit payments.

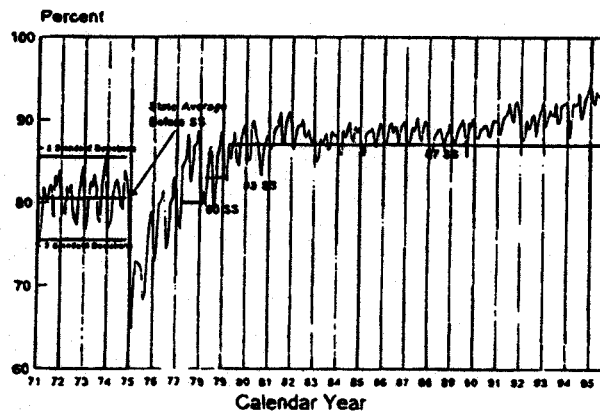
Another substantial change was the emphasis on timeliness in the payment of benefits. In 1970, the U.S. Supreme Court issued the *Java* decision which provided that State laws must provide for payment of UI as soon as administratively feasible after notice and opportunity for a hearing to worker and employer. The court's rationale was that only prompt replacement of lost earnings effectuates the purpose of the UI program by allowing workers to meet living expenses and cushion the immediate effects of unemployment throughout the economy.

Timeliness for benefit payments is measured by the days between the filing of the claim and the first payment. Department of Labor regulations provide that 87 percent of all first intrastate payments must be made within 14 days of the end of the first compensable week. (Within 21 days in States with no waiting week.) In the early 1970s, timely first payments fluctuated widely - between 75 percent and 85 percent were made within 14/21 days. In a recessionary year, first payment timeliness dipped well below 70 percent. In recent years, over 90 percent are made within 14/21 days and the most recent recession did not appreciably affect timeliness.

Timeliness of appeals is measured by elapsed days from the date the claim is disputed to the date of decision. The Department of Labor also established regulations requiring 60 percent of all lower authority benefit appeals be disposed of within 30 days. In the early 1970s, States were disposing of only slightly more than 20 percent timely. Since the mid-1980s, with the exception of a dip in the early 1990s, more than 60 percent of all appeals have been disposed of timely.

Figures 23 and 24 show the national performance against these requirements.

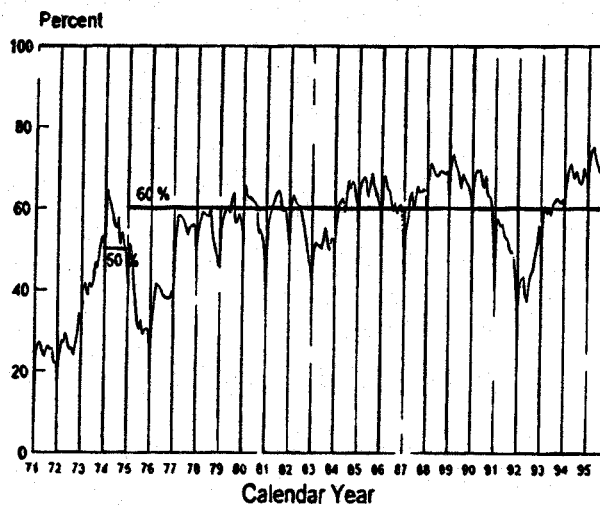
Timeliness of First Payments, Impact of Standards Created by Secretary of Labor, 1971-1995
U.S. Average, All States



NOTE: 90% SS effective 4/1/77 to 3/31/78; 85% SS effective 4/1/78 to 3/31/79; 87% SS effective 4/1/79 forward.

Figure 23

Promptness of Disposition of Lower Authority Appeals: Introduction of Standards Created by U.S. Secretary of Labor, 1971-1995, U.S. Average, All States



NOTE: 50% SS effective calendar year 1974; 60% SS effective

Figure 24

UI Service Delivery

In the beginning of the program, workers filed initial claims in person in a local office, and subsequently reported to the local office to certify that they met the eligibility requirements and to receive cash payments. (Since eligibility is determined on a weekly basis, the workers usually reported weekly or every other week.) Over the years, the States have gradually moved to systems requiring less of a claimant presence in the local office. Workers in many States report in-person only to file an initial claim. They then mail their weekly claims or use voice response units. More recently, some States have started taking initial claims by telephone. Some States may soon permit workers to use the Internet to file initial claims. This has resulted in convenience for the worker who no longer has to bear the cost of going to a local office and reduced costs for the State UI agency. (In fact, much of the automation occurred because States could no longer afford to keep local offices open.) At the same time, this phenomenon is changing the visibility of UI activities and raising questions about the UI program's relationship with other workforce development system services, especially for reemployment of workers. (Many of these other systems are going to centralized "one-stop" sites where UI may or may not be present.) The effects these changes have on system integrity, costs and service delivery are not yet fully understood.

Tax operations have undergone a similar, but not as widespread, evolution to automated processes. Initially, employers filed tax and wage reports quarterly on paper forms, and employer accounts were maintained on manual ledgers. In the 1970s, most States converted to electronic accounting systems which evolved to remittance processing systems in which quarterly transactions are machine read into computer files in high speed computer imaging operations. Many variations of these techniques exist. Also, in many States, employers are given the option to report by electronic media, even by Internet access in some States. In a few States taxes are paid by electronic fund transfer.

Computer systems have been established which automate accounting and recordkeeping processes such as report and tax delinquency notices, wage verification, account auditing, legal notices and many other formerly staff intensive activities. In addition to reducing the burden for the State UI tax operations, these technologies have also reduced the burden on the employer of maintaining records and filing tax returns, which are filed electronically in many States.

To further reduce reporting and recordkeeping for employers, the Department of Labor joined with the SSA and the Treasury Department (including the IRS) in 1995 in a Memorandum of Understanding which officially established the Simplified Tax and Wage Reporting System Project Office. This project, made up of individuals from all of these agencies, has tested new technological methods for the joint registration of employers and filing of tax and wage reports.

Efforts to relieve employer reporting burdens have led some States to reorganize State government, so that all taxing activities, including UI, are housed within one administrative entity. Other States have revised employer registration forms to accommodate multi-agency requirements and to allow employers to report to one taxing authority which then shares the information with others.

VI. UI ADMINISTRATIVE FINANCING

Congressional Appropriations

The SSA requires the Secretary of Labor to provide each State with such amounts as the Secretary determines to be necessary for proper and efficient administration of the State's UI program during the fiscal year. Of course, the Secretary can only provide what has been appropriated by Congress. Since the earliest days of the UI program, the adequacy of the amount appropriated has been a matter of debate.

When the original SSA was enacted, Congress decided that one hundred percent of the cost of State administration would be financed from Federal grants. (There are no State "matching" funds for administration.) This decision was based on concerns that State legislatures would not appropriate sufficient funds for administration, on a desire for States to administer their laws properly and efficiently (the Federal legislation included certain administrative standards as a condition for receiving Federal administrative grants), and on the need for flexibility (many State legislatures met infrequently for brief periods, had access to very limited resources and would not be able to respond as quickly as Congress to provide supplemental appropriations in times of economic recession and rapidly increasing workloads).

Despite this Federal funding responsibility, Congress did not establish a link between the amount of FUTA receipts and grants to States. By 1952, about \$1 billion more revenues had been collected in FUTA taxes than had been appropriated for administration. As a result, Congress passed the "Reed Act" (Public Law 83-567) in 1954. The Reed Act provides that funds collected from FUTA taxes must be used for Federal and State administration of the program. If more funds were collected than were needed for administration, the "excess" funds would be returned to the States. Reed Act distributions were made in 1956, 1957 and 1958.

The Reed Act did not resolve the funding debate. In fact, it was only in 1965 that, for the first time, Congress appropriated the amount equal to the ceiling in the President's budget request. Another problem was that Congress' initial appropriation was often insufficient to meet unanticipated increases in workload. As a result, Congress needed to provide supplemental funding for UI administration ten times between 1974 and 1991. This problem seems to have been resolved when, beginning in Federal fiscal year 1992, Congress adopted a system that automatically provides additional funds within limits (called contingency reserve funds) for workload above the level anticipated in the President's budget request.

Another issue is that all trust funds, including the Federal and State accounts in the UTF, have been included in the Federal budget process since 1969. Thus, despite its dedicated funding source, UI administrative funding is subject to Federal budgetary considerations. The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings or GRH I) provided that administrative funds could be subject to across the board reductions under certain budget deficit conditions. This Act and its successor, GRH II, resulted in reductions of UI administrative funds in Federal fiscal years 1987, 1989 and 1990.

Amendments to the GRH Acts by the Budget Enforcement Act (BEA) also affected funding. Under the BEA, expenditures are divided into two categories: "mandatory" and "discretionary." The BEA established annual caps for discretionary spending and a "pay-as-you-go" requirement for mandatory spending and revenue legislation. Expenditures for UI benefits and the collection of the FUTA tax costs are classified as "mandatory," while expenditures for all other administrative costs are classified as "discretionary."

For UI, this means that although benefits are payable without restriction, the UI program has to compete with other discretionary programs for administrative funds. Thus, if UI workload rises and States need additional resources, any increase in UI administrative funding must be offset by savings from other discretionary programs to fit within the discretionary cap.

An additional complication under the BEA is that savings in mandatory spending may not be used to offset increases in discretionary spending. For example, the Administration proposed an

additional \$89 million in UI administrative funding for integrity activities for FY 1998. The improvements derived from these activities were estimated to save over \$100 million in benefit costs for the fiscal year. However, under BEA rules, savings in the mandatory UI benefits could not be used to offset increases in discretionary administrative costs. As a result, despite the savings outweighing the expenditures, the UI program unsuccessfully competed with other discretionary programs for the \$89 million.

Similarly, discretionary savings may not be used to increase mandatory spending. Under "pay-as-you-go" requirements for mandatory spending, any law change increasing UI benefit outlays must be paid for through cuts in entitlement spending or by tax revenues regardless of whether the UTF balance is sufficient to cover costs. If, for example, the Federal government turned responsibility for administrative financing over to the States, there would be a \$3.6 billion reduction in Federal discretionary spending. Under the BEA, this reduction could not be used to increase mandatory spending which would be necessary if administrative funds were shifted from discretionary to mandatory.

Allocating the Appropriation to the States

A second area related to funding is the method used by the Department of Labor to allocate amounts to the States. Debates have occurred about whether the allocation methodology provides stable and adequate funding, equitably allocates resources, and promotes cost-effective practices.

In 1941, a system of budgeting by functions was adopted wherein the volume of workload and the cost per unit were determined. For example, the number of initial claims would be estimated and multiplied by the estimate of the cost per claim to determine the total cost to process initial claims for the budget period. This system was enhanced in the early 1970s through the UI Cost Model, which included a program of work measurement studies which were conducted in every State and updated through the mid-1980s. This system established over seven hundred discrete activities in State UI programs which were called master product codes. These basic building blocks of the Cost Model system were aggregated into the broad activities of initial claims taking, weeks claimed, appeals, nonmonetary determinations, tax and wage records. These broadband "minutes per unit" have been used since the early 1970s to allocate the UI administrative budget to the States. However, the Cost Model management system ended in the mid-1980s, and no minutes per unit values have been updated since that time. The data derived from this system are, with some adjustments, still in use today.

There has been no agreement on how to improve the method of allocation. In 1985, the Department of Labor began the Administrative Financing Initiative (AFI) to search for alternative funding methodologies. No consensus was reached, although certain short-term changes were adopted in 1986, including simplification of State reporting, extending the grant funding period, and more flexibility in how States expended funds, that is, bottom-line authority.

Again, in early 1992, the Department of Labor began to design and develop an administrative financing proposal as required by Public Law 102-164, enacted in November 1991. This led to the reconstitution of the AFI which proposed using two national unit costs - one for benefits and one for tax - to fund States. Differences in the cost of doing business among the States were accounted for by indexing each State's cost of living. Also, an additional adjustment would be made for States with small populations to recognize their cost problems. The AFI product was not adopted for two reasons. First, although AFI would have provided more money to States, some States would have lost funding and opposed the proposal. Second, the budgetary climate in which the Congress asked for the report changed considerably over the course of the project.

VII. THE EMPLOYMENT SERVICE AND OTHER PROGRAMS

The "reemployment services" offered by the ES include job search assistance and job placement services such as counseling, testing, and providing occupational and labor market information, assessment, job search workshops, job clubs, and referrals to employment.

The primary provider of public reemployment services is the ES. Special services are also provided to veterans. Information concerning the local labor market is a necessity in providing reliable reemployment services. ES, veterans services, and labor market information are funded from the FUTA tax.

ES predates the UI program. The Wagner-Peyser Act of 1933 established the Federal-State ES whose primary mission is to function as a labor exchange which matches workers to jobs and employers to qualified workers. With the advent of UI in 1935, "the functions of the ES were expanded to add work registration of UI workers to the original job-matching goal. Although the mission of the ES has spread far beyond labor exchange activities over the last sixty years, the relationship of the ES with the UI program has historically focused on two fundamental roles: the work test and reemployment services."³⁵

The relationship between the ES and UI programs is grounded in the FUTA and the SSA requirements that UI be paid through public employment offices and the Wagner-Peyser Act's requirements to coordinate UI services and labor exchange services and to provide job finding and placement services to workers claiming UI.

Initially, ES consisted primarily of selection and referral for UI and ES job seekers to available employment opportunities within the community. The process was simple as ES staff reviewed employment experience against available employment opportunities within the community and, if a match was appropriate, a referral was made. This service is available in each State through a network of currently over 1,800 ES local offices throughout the U.S. and workers have the opportunity to seek employment nationally through interstate job listings available at local offices. Over time, computer lists were generated for job seekers to browse and seek referral services after consultation with an ES interviewer.

These activities have been supplemented by America's Job Bank (AJB) and America's Talent Bank (ATB) which use Internet technology to provide job finding and search services to Americans seeking first, new and better jobs. The AJB is a computerized bank of multiple job listings to help job seekers and employers find each other. It provides employers with the widest available distribution of their job openings and job seekers with the largest available pool of active opportunities. The ATB, which is being implemented nationally, permits employers to search a pool of resumes to find qualified job candidates and gives both unemployed and currently employed job seekers a new opportunity to tap into a broader market. The Department of Labor is currently funding a project to explore the automatic connection between a remote claim and the ATB which would immediately connect unemployed workers with jobs.

In the 1980s, a number of demonstration projects tested the effects of enhanced job search assistance services for workers claiming UI. These tests suggested that enhanced job search assistance could speed return to work and reduce the duration of unemployment. These results led the administration to propose and Congress to enact Public Law 103-152 in 1993 to establish the Worker Profiling and Reemployment Services initiative. This program consists of two processes: (1) early identification and referral to reemployment services of those workers most likely to exhaust their benefits and who need reemployment services; and (2) early intervention to link them with reemployment services to speed their return to work. Ten percent of those identified as likely to exhaust and in need of reemployment services were referred to services in 1996. According to a Department of Labor study, State ES agencies were the primary agency responsible for developing and delivering job search services.

Beginning in the early 1990s, States began consolidating their delivery of program services into workforce development systems, of which UI and ES are component programs. The goal of these efforts is to improve service delivery for all job seekers. The Department of Labor has

supported this movement through the One-Stop Career Center initiative, including implementation grants to States and waiving Federal regulatory requirements, especially in JTPA programs.

According to a Department of Labor study, Wagner-Peyser Act funding will be an essential glue that holds together the entire One-Stop enterprise.³⁶ Public labor exchange services will likely be the most commonly used services in the network of State workforce development systems.

ENDNOTES

1. See Global Preparedness and Human Resources, 1994, p. 13.
2. See Statistical Abstract of the United States, 1979, p. 803; and Statistical Abstract of the United States, 1996, p. 746.
3. See Report on the American Workforce, U.S. Department of Labor, 1995, pp. 146-147.
4. See Statistical Abstract of the United States, 1996, p. 400.
5. See Urban Institute, Immigration & Immigrants: Setting the Record Straight, 1994, p. 40.
6. See American Economic Review, May 1996, p. 246.
7. See Urban Institute, Immigration & Immigrants: Setting the Record Straight, p. 40.
8. See Work Force 2020, 1997, p. 92.
9. See Blank and Card, "Recent Trends in Insured and Uninsured Unemployment: Is There An Explanation?", Quarterly Journal of Economics, 1991, 106:1157-1189.
10. See Bureau of Labor Statistics, Time Series Data.
11. See Hipple, "Worker Displacement in an Expanding Economy," Monthly Labor Review, December 1997, p. 32.
12. See Employee Tenure in the Mid-1990s, Bureau of Labor Statistics, January 1997.
13. See Houseman, Temporary, Part-Time, and Contract Employment in the United States: A Report on the W.E. Upjohn Institute's Employer Survey on Flexible Staffing Policies, 1997.
14. See Loungani and Trehan, "Explaining Unemployment: Sectoral vs. Aggregate Shocks," Economic Review, Number 1, 1997, p. 9.
15. All data is from the U.S. Department of Labor's analysis of State data submitted on the Characteristics of the Insured Unemployed (ETA 203) Report, except for the age of job losers which is from the Current Population Survey.
16. Data from the U.S. Department of Labor's analysis of Benefits Accuracy Measure (Benefits Quality Control) data.
17. See Haber and Murray, Unemployment Insurance in the American Economy, 1966, p. 26.
18. Ibid. p. 26.
19. See Advisory Council on Unemployment Compensation Final Report, January 1996.
20. See Rubin, Federal-State Relationships in Unemployment Insurance, 1983.
21. See Advisory Council on Unemployment Compensation, Defining Federal and State Roles in Unemployment Insurance, 1996, pp 7-9.

22. See Wagner-Peyser Act, Section 7(a)(3)(F), 1933.
23. See Bassi and McMurrer, "Coverage and Reciprocity" in Unemployment Insurance in the United States: Analysis of Policy Issues, O'Leary and Wandner (eds), 1997, pp. 51-89.
24. See Vroman, "Labor Market Changes and Unemployment Insurance Benefit Availability," research conducted for the U.S. Department of Labor, January 1998, pp. 5-29.
25. See "Adequacy of the Weekly Benefit Amount" by O'Leary and Rubin in Unemployment Insurance in the United States: Analysis of Policy Issues, O'Leary and Wandner (eds), 1997, pp. 163-210.
26. The range of views is reflected in three different papers in Advisory Council on Unemployment Compensation: Background Papers. For the case that levels are too generous, see Gruber, "The Consumption Smoothing Benefits of Unemployment Insurance" in Volume 1, July 1995. For the case that levels are not sufficient, see Davidson and Woodbury, "Optimal Unemployment Insurance" in Volume III, July 1995. For a study occupying the middle ground see Hamermesh and Slesnick, "Unemployment Insurance and Household Welfare: Microeconomic Evidence 1980-1993" in Volume III, January 1996.
27. Data from the U.S. Department of Labor's analysis of Benefits Accuracy Measurement data.
28. See Dunson, Maurice and Dwyer, The Cyclical Effects of the Unemployment Insurance Program, Metrica, Inc. 1990, issued as UI Occasional Paper 91-3.
29. See Hamermesh, "Factor Market Dynamics and the Incidence of Taxes and Subsidies" in the Quarterly Journal of Economics, December 1980; and Hamermesh, Labor Demand, Princeton, 1993.
30. See Advisory Council on Unemployment Compensation, Unemployment in the United States: Benefits, Financing, Coverage, 1995, p.9.
31. Ibid. pp 8-9.
32. See Levine, "Financing Benefit Payments" Unemployment Insurance in the United States: Analysis of Policy Issues, O'Leary and Wandner, 1997, pp. 338-352.
33. See Burgess and Low, Unemployment Insurance and Employer Layoffs, 1993, issued as UI Occasional Paper 93-1.
34. See Haber and Murray, Unemployment Insurance in the American Economy, 1966, p. 451.
35. See Balducchi, Johnson and Geitz, "The Role of the Employment Service" in Unemployment Insurance in the United States: Analysis of Policy Issues, O'Leary and Wandner, 1997, p. 460.
36. See Evaluation Report of One-Stop Implementation Experience, Social Policy Research, 1997, pp. 6-26