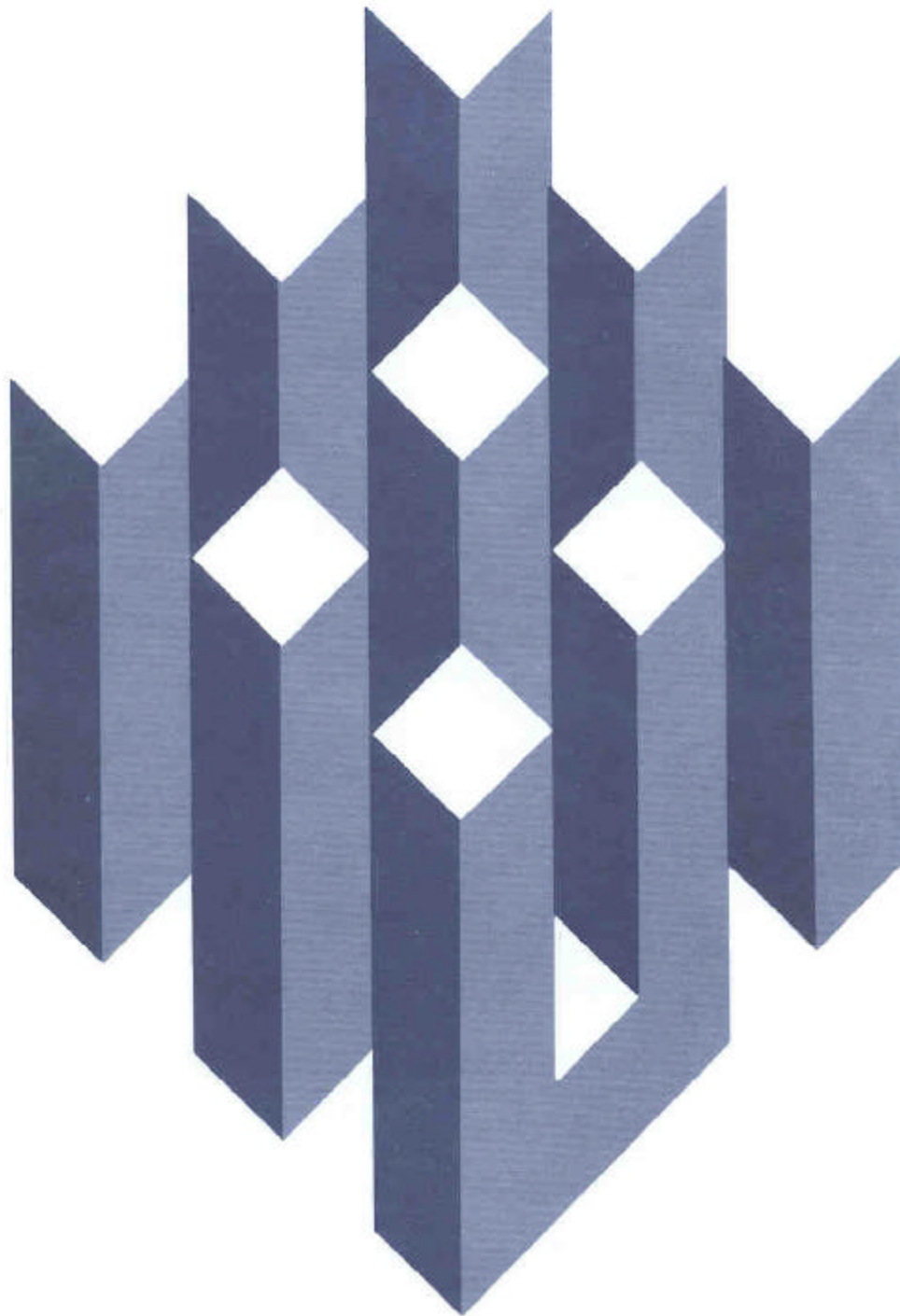


Unemployment Compensation in Varying Phases of Joblessness



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Employment and Training Administration
Ernest G. Green
Assistant Secretary for Employment and Training

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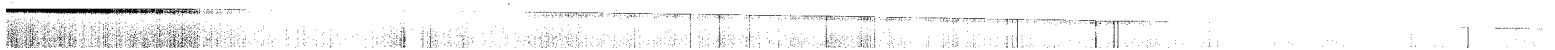
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ABSTRACT

This paper discusses the role of unemployment insurance in society's overall effort to provide people with income security. The unique goal of unemployment insurance is indicated as distinct from that of welfare programs. The course of unemployment is traced with respect to beneficiaries' prospects for reemployment and their concomitant standard of living. The consequent transformation of the UI goal of helping to maintain the beneficiaries' standard of living is discussed. A gradual merging of UI type and welfare type income maintenance goals takes place, with implications for the financing scheme of unemployment benefits for the long-term unemployed. The author advocates conceptual distinction of unemployment insurance per se, applicable to the initial phase of joblessness, from unemployment compensation, applicable to long-term unemployment.

This paper emphasizes the fundamental importance of job security for all able workers as a means of achieving their income maintenance, with a direct payment approach such as through unemployment insurance programs only as a last resort to attain income security. For this reason, emphasis is placed on the importance of: (1) a preventive labor market policy directed at employed workers in the face of dynamic changes in the economy; (2) continued unemployment benefits during extended unemployment partly to subsidize the beneficiary's labor market and job search expenses; and, (3) intensive governmental efforts to match jobs and workers. This troika of policy measures would enhance substantively the efficacy of unemployment insurance as an employment security program. Further, a clear delineation of the functions of unemployment insurance that emerges will define the division of labor between unemployment insurance and welfare programs in providing the society with comprehensive income maintenance.



UNEMPLOYMENT COMPENSATION IN VARYING PHASES OF JOBLESSNESS

The recent clamor for welfare reform leads us to a re-examination of individual income maintenance programs and the interrelationship among them. Unemployment insurance (UI) is one such program. In this author's observation, the basic tenet of unemployment insurance in this country that sets it apart from the so-called welfare programs (e.g., Aid for Families with Dependent Children, commonly referred to as AFDC) is to help experienced workers maintain their customary standard of living when they are unemployed, through no fault of their own, for a temporary period of time. This tenet is not always fully understood by the public and, more crucially, by those who determine policy direction. The intent of this paper is to discuss the goals and distinguishing features of unemployment insurance so that any overall "welfare" reform will be made with a proper perspective.

Distinction Between Welfare Type and UI Type Income Support Programs

Income subsidy of poor families is one facet of income transfer aimed at the goal of maximizing the collective satisfaction individuals derive from their lives and unemployment benefits to jobless workers is another facet. Although there may be some crossover among recipients, ^{1/} the two programs are quite distinct from each other with respect to the income level each program is intended to protect. An income maintenance program may be designed to enable the recipient families, often without working age members, to achieve the minimum standard of living that the society deems necessary to preserve their human dignity. In comparison, an income maintenance program may be aimed at preserving the varying levels of living the beneficiaries have attained regardless of how close these levels are to the minimum acceptable level. This difference in the income maintenance objectives distinguishes the so-called welfare programs from UI.

Reduction in the society's total well-being because workers are forced to reduce their unique standards of living must be just as much of a concern to the society as guaranteeing at least the minimum standard of living for all persons. For unemployment, with the immediate loss of income, is likely to leave a permanently adverse imprint on the displaced workers' lives and their lifetime earnings which does impair their unique standards of living.

Need for Income Maintenance

We, as consumers, derive much of our life's pleasure from the flow of service -- be it having a roof over our heads, the use of automobiles or enjoying comfortable temperature through air conditioning. It is, to a large extent, the amount and the quality of such service flows that determine our standard of living. When we pay house rental for shelter or for use of taxis for transportation, we pay only for the service rendered. Alternatively, the same service flows may be obtained through ownership of the sources of these service flows, as exemplified by house ownership, automobile purchase, purchase of household appliances and a whole host of other purchases of the stock of goods from which we derive uses.

Many American workers have achieved a level of living far in excess of the minimum subsistence level, at which the principal concern is the provision of food and shelter. At this living level, the dominant concern is to preserve and improve upon the level that has already been attained.

Furthermore, usually associated with a comparatively high income level are proportionately large illiquid assets held by the workers. At this level, the workers are likely to own many of the means of generating service flows rather than directly purchasing uses themselves.

In concrete terms, they have made an investment in houses, automobiles, etc. Preponderance of such illiquid asset holding is likely to hamper the workers' adaptability to the contingencies necessitated by a sudden earnings loss. One can easily imagine a situation where a suddenly displaced worker, while having to forego newly purchased appliances, gets stuck with continuing monthly payments, on the one hand, or is unable to recover the purchase price less wear and tear, on the other. This occurs because more often than not the market value of the consumer durable goods depreciates drastically once they leave retail stores, regardless of the degree of use. Automobiles are a familiar example which are commonly said to depreciate 20 percent as soon as the buyers drive them out of showrooms. With a view to long range use of consumer durable goods, such depreciation may be amortized over many years. But scaling down of the standard of living necessitated by a sudden loss of income would cause a tremendous jolt to the financial status of the worker and would be highly ineffectual, only disrupting the service flow without concomitant expenditure reduction. It is easy, therefore, to understand that the reduction in living standard a jobless worker may be compelled to undergo tends to be more than in proportion to lost wages. It follows, then, that American workers, who are likely to have established comfortable living and yet are subject to the hazard of unemployment, would suffer a disproportionately large share of real income loss in the event of unemployment--not to speak of the anxieties that go with it. There is clearly a rationale for income maintenance of the unemployment insurance type which gears its benefits to the level of previous earnings and is aimed at preventing such drastic erosion of the workers' well-being.

Further, the accumulated total loss in the society's well-being due to the joblessness of many workers would be enormous had there been no provision for a buffer such as that provided by unemployment

benefits. The extent of such loss varies depending on the economic condition and the kinds of people involved. Nevertheless, the magnitude of the loss can readily be gleaned when it is realized that, for example, with an average unemployment rate of 6.9 percent during the second quarter of 1977, 6.75 million workers were out of jobs. If we assume that, on the average, these workers had earned \$218 per week and subsequently experienced 14 weeks of unemployment, the resulting earnings loss could amount to over 20 billion dollars. 2/

In addition to the actual earnings loss by the unemployed workers, there are also social losses. A catalog of such losses would include the following: First, in their attempt to preserve family integrity, jobless workers may be compelled to accept almost any jobs, regardless of how suitable they are to the skills they possess. Because a worker's skill represents an investment, acceptance of jobs less than suitable to the skills they possess means a wasted investment in human capital.

Second, income earning capacity of workers may be permanently impaired. It is a fact in today's labor market that, once a worker accepts a job at a certain level, it is very difficult to move up. From the worker's personal standpoint, therefore, the acceptance of jobs at a level lower than his/her capacity is likely to lead to an irrecoverable loss of future income.

Third, the financial pressure which results from unemployment of a wage earner in the family can compel other members of the family to seek employment. This can very well aggravate high unemployment which initially caused the wage earner's joblessness.

Fourth, if there were no measures to provide a buffer, the consumers would likely reduce making long-term investments, such as home buying, or making an

intangible commitment such as education. As a consequence, economic activities of the society would be inhibited. It is even conceivable that prices might ultimately be higher than they actually are since the reduction of consumer purchases could restrict production to take advantage of the scale economy.

Mechanism of Unemployment Benefits

Before we proceed further, it may be useful to describe the mechanism of determining unemployment benefits in order to facilitate understanding of the salient issues involved here. From the inception of the unemployment insurance program in this country, the weekly benefit amounts have been in direct proportion to the beneficiaries' previous weekly wages up to a certain maximum rather than scaled to minimal expenditure needs while unemployed. This wage loss replacement principle emanates from the view that a worker's attained standard of living is closely related to his/her usual earnings; thus, benefit amounts are necessarily geared to usual earnings in order to help preserve the diverse accustomed standards of living.

Weekly Benefit Formula

Although, under the Federal-State system of unemployment insurance, individual state laws have varying methods of computing weekly benefit amounts, the underlying principle in all state laws is common. Under the Federal policy goal, the weekly benefit amounts (WBA's) are aimed at compensating 50 percent of lost "usual" weekly wages. There are, however, differing definitions of "usual" weekly wages among the states. This variation is reflected in the unique benefit formula of each state. There are three distinct types of benefit formulas -- the high quarter wage formula, the average weekly wage formula and the annual wage formula.

In the high quarter wage formula states, the weekly benefit amounts are determined, in essence, as a fraction of the beneficiary's weekly earnings in the base period quarter in which the most wages are earned in employment covered by unemployment insurance.^{3/} This approach assumes that average weekly earnings in the high quarter are the "usual" earnings of the claimants. The most frequently used fraction applied to the

high quarter earnings under this formula is $1/26$ -- i.e., the weekly benefit amount (WBA) is $1/26$ of high quarter earnings. With the policy goal of attaining 50 percent wage loss replacement, the use of the $1/26$ fraction implies that a claimant worked 13 full weeks in the high quarter, thus yielding an average weekly wage for the high quarter of $1/13$ of the high quarter wage. A 50 percent replacement of this average weekly wage is the same as $1/26$ of high quarter wages. In some states the underlying assumption is that the workers may have worked fewer than 13 weeks in the high quarter, thus making the fractions larger than $1/26$. This leads to variation in the fractions used to determine the WBA's among the high quarter wage formula states. This benefit formula is used in 39 states with variations in specific provisions.

The calculation of the weekly benefit amount under the average weekly wage formula includes the entire base period wages as a basis for deriving the weekly wage. Specifically, the weekly benefit amount under this formula is determined as a fraction (say, 50 percent) of the total base period wages in covered employment divided by the number of weeks worked in corresponding employment. There are eight states and Puerto Rico that use this formula in several variations. Unlike the annual wage formula, the average weekly wage formula does not assume a fixed number of weeks worked by all beneficiaries in their base periods. The computation of the average weekly wage is instead based on the weeks actually worked. 4/

Under the annual wage formula weekly benefit amounts are a percent of the wages earned in covered employment in the base period -- e.g., 1.25 percent in Oregon. Implicit in this formula is the assumption that all beneficiaries worked some fixed number of weeks in the base period (say, 45 weeks). An "average" weekly wage is derived by dividing that constant into the base period earnings. With a 50 percent replacement, the annual wage fraction with a 45-week base period would be 1.11

percent. In reality, however, the benefit fractions in all four states that have this formula are generally more generous, ranging from a low of approximately 1.1 percent to a high of 2.3 percent. 5/

Maximum Weekly Benefit Amount

The degree to which unemployment insurance can help maintain the beneficiary's standard of living is restricted by, in addition to the 50 percent wage loss replacement ratio recommended by the Federal standard, the existence of maximum weekly benefit amounts. In fact, the ceiling imposed by the maximum WBA precludes a large number of claimants from receiving even 50 percent of wages lost. 6/ If we assume that the 50 percent replacement principle is applicable to the weekly benefits up to the maximum, we can view the amount equal to twice the maximum weekly benefit amount as the weekly wage which enables a claimant to receive the maximum WBA. Thus, a claimant needs to have earned, with the exception of the District of Columbia and Puerto Rico, between \$120 and \$250 in "usual" weekly wage in order to qualify for the basic maximum weekly benefit. 7/ In terms of high quarter wages, the same claimant needs to have earned as little as \$1,560 to \$3,125 in a quarter. 8/ Clearly, many claimants have earned high quarter wages greater than these.

Financing of Unemployment Insurance

The two distinct characteristics of the financing scheme of unemployment insurance in this country are that the benefit costs are financed by the revenue from employer tax 9/ and that the individual employer tax is experience rated. The former contrasts with the financing in most other countries where employee contributions and general revenue funds play important roles in the financing of their unemployment compensation systems. 10/ Under the experience rating system, each employer is assessed the tax rate determined by the cost

of unemployment benefits paid to former employees relative to the amount paid in the fund. 11/ The underlying principle of this system is that employers are regarded responsible for the stability of employment. Thus, within the constraint of the maximum tax rate, the benefits that are charged to employer accounts ultimately are translated into higher or lower tax rates under the experience rating system. Thus, the employers are implicitly held accountable for the unemployment of their former employees for the duration of benefit payments under the regular UI program.

Two parameters determine the tax payment of an employer -- namely, the taxable wage base and the tax rate. The taxable wage base, the maximum total base period wage on which unemployment tax is paid, is in most states \$6,000. Individual employers' tax rates vary according to their past benefit experience. The Federal Unemployment Tax Act sets the Federal payroll tax at 3.2 percent of the payroll up to the wage base. Employers are permitted to credit 2.7 percent of this amount towards the state tax paid under the approved state law. The so-called standard rate in most states, therefore, is this 2.7 percent, if paid together with the additional .5 percent of the Federal tax, that would fulfill the 3.2 percent Federal payroll tax requirement. However, under the experience rating system, individual employers' tax rates can be higher or lower than 2.7 percent determined by the amount of benefits charged to their accounts. Accordingly, the range within which the state tax rates can vary is quite diverse among the states. Some states have a minimum rate of zero percent and some have a maximum rate as high as 7.5 percent. In most states the minimum and maximum rates fall between these extreme values. As a rule, new employers pay the "standard" rate until they are experience rated.

How Do Different Income Maintenance Goals Merge?

Some of the frequently asked questions regarding unemployment insurance are: "How many recipients of unemployment benefits receive welfare at the same time?" and, "How many people go on welfare after they exhaust their unemployment benefits?" Thus, the extent of the intersection of unemployment insurance and welfare programs continues to intrigue the public. However, the real issue is the relevance of the UI type income maintenance as the joblessness of a worker persists. Thus, our question is: "Is it possible that these two distinct types of income maintenance ever merge?" The answer is: "Yes, the two can dovetail over the course of a UI claimant's unemployment."

Changes in the Income Maintenance Goal

The UI objective of protecting the worker's customary standard of living, when pursued to the extreme, may not only lead to an excessive drain of UI funds but also be in conflict with the social concern of the full utilization of human capital. Each week that a worker is unemployed the society loses permanently what the unemployed workers could contribute to the society, if employed. There is, of course, a trade-off between the foregone loss and the potential gain from job search which ultimately provides a means of return to the worker's customary standard of living and full use of productive capacity. To be truly fruitful, however, the job search must restore the workers' customary standard of living through "suitable" work. As will be discussed later, the probability of this happening tends to vary (or, diminish) as unemployment continues. The "suitable" work provision of the unemployment insurance program and what "suitable" work means are critically important for these reasons.

Suitable Work

The "suitable" work provision requires the beneficiaries to be able and willing to accept "suitable" job offers which generate earnings equivalent to the previous earnings, or earnings that a worker can reasonably expect to receive. Stated differently, this provision allows the beneficiaries to postpone job acceptance until suitable jobs are found which, after discounting all the attending costs incurred in new jobs (additional commuting cost, cost of relocation, etc.), yield a wage in real terms comparable to the earnings from previous jobs. Thus, at least at the outset of unemployment, the suitable work provision seeks to restore the workers' customary standard of living. Obviously, it is preferable to attain this goal by enabling the workers to find suitable jobs than by direct and non-self-sustaining transfer payments.

The question, however, is: How reasonable is it at any point during the period of unemployment to expect a worker to be able to find suitable work defined as such? The answer hinges on (1) the present and future availability of jobs in the line of work the worker has been used to, and (2) the extent to which the unemployed workers retain their skill and employability. Thus, any changes in either the demand or the supply conditions can make the goal of returning the workers to their accustomed jobs unattainable. If this happens, in order to bring the beneficiaries under such circumstances back to the mainstream of the work force, the concept of "suitable" job applicable to such workers may need to be relaxed. Then, the terms and conditions of employment, which define a suitable job, have to be reevaluated.

In practice, the prospect of eventually returning to the accustomed work is bright for most workers at the beginning of their unemployment. During this early phase it is reasonable to give beneficiaries a chance to look for employment paying wages comparable to the

previous wages without jeopardizing their UI eligibility. The applicable suitable job provision would be one of "customary" work.

Benefit Duration

But, how long should a UI beneficiary be allowed to pursue "customary " work under the "suitable" job provision? The question is at the heart of the issue of unemployment benefit duration adequacy. This is the gray area where welfare and UI type income maintenance goals may intermesh. On the one hand, as long as a beneficiary can expect to have a reasonable prospect of finding a job in the line of work to which he/she is accustomed, the reattainment of the customary standard of living through work is implied. Helping tide beneficiaries over the "temporary" period of joblessness and possibly aiding in job search is within the domain of the UI type income maintenance program. On the other hand, after a period of unemployment the probability of finding work at a wage level comparable to that of the previous employment may drastically decline because of the persistent lack of employment opportunity in the accustomed field or because the workers' skill deteriorates. Then, the prospect of regaining the customary living level through employment diminishes. If this happens, the payment of unemployment benefits determined solely by the criterion of the customary standard of living becomes untenable unless adequate measures are made available to restore the chance of finding jobs at the previous wage level.

It is commonly believed that a worker's skill frequently deteriorates while unused. Furthermore, even where actual deterioration does not occur, the imagined loss of productive skill as perceived by prospective employers tends to limit the reemployment opportunities of the unemployed workers. This change in the supply characteristics of unemployed workers over time, whether it is real or imagined, alienates them from the labor market. Further, where labor market

conditions are generally tight, where there has been a shrinkage in demand for their skills, or where they face stiff competition from younger job seekers with lower wage requirements, the difficulty of finding employment increases. As the search for work is prolonged, the asking wage tends to decline. This may partly reflect the workers' realization of this change. Obviously, in this phase of unemployment, workers' "suitable" work, viewed from the standpoint of the potentially attainable jobs rather than the customary work, would differ from that which is applicable in the initial stage of unemployment. From the UI policy standpoint, this suggests the need for flexibility in the concept of "suitability"; otherwise, a rigid adherence to the idea that a worker's suitable job is that which restores his/her previous standard of living may only lead to permanent joblessness.

For a while after the onset of joblessness, however, it must be reasonable to expect that the unemployed workers' productivity and employability remain intact. Actual skill deterioration is not likely to begin instantaneously upon displacement nor are the potential employers' views of worker productivity likely to be influenced by a brief period of unemployment. It seems reasonable for this period to view the "suitable" job as the previously accustomed job and to gear the weekly benefit amount accordingly. Such period should be the basic benefit duration with the full WBA geared to the customary standard of living; and, it should serve as the basic reference in determining "adequate" benefit duration. Obviously, the duration in which one's skill marketability remains unchanged varies depending on his/her background. This, perhaps, is one area where an intensive study needs be done in connection with the issue of duration adequacy.

The notion that an unemployed worker can reasonably expect to return to employment at the accustomed wage rate for a certain period at the initial stage of unemployment may be supported by

the result of the post-exhaustion surveys conducted in California, Nevada and New York during 1973-74. ^{12/} In each of these States, the majority of the UI regular benefit exhaustees, who were subsequently reemployed, were found to hold jobs that paid at least the same wage as the previous jobs and were at least as satisfactory as the previous jobs. Table 1 shows the percentage distribution of the reemployed exhaustees by the number of weeks between exhaustion and the new job and by the job comparison. In New York, for the reemployed exhaustees, the new and previous jobs were also compared during the 26th week after UI benefit exhaustion.

Again, most of the exhaustees found the new jobs as remunerative and satisfactory as the old jobs. Table 2 presents the percentage distribution of these exhaustees by job comparison and by eligibility for extended benefits. Both of these results are consistent with the view that jobs remain available to a large portion of unemployed workers at the accustomed wages at least for the duration currently prescribed by the respective state UI provisions.

If prolonged joblessness is due strictly to the cyclical scarcity of jobs and, more importantly, if there exists a fairly good prospect of improved job opportunity, an extended protection falls well within the purview of the basic UI income maintenance goal, provided that the beneficiaries continue to possess marketable skills once the demand condition returns to normalcy. However, it is with respect to those whose employability diminishes that serious thinking is called for about the propriety, from the economic efficiency standpoint as well as from the UI financing standpoint, of dealing with the problem of their income and ultimately of their job security through the single approach of unemployment insurance. For example, given a rapid recovery in the 1977-78 U.S. economy, it seems that many of the beneficiaries of the renewed Federal Supplemental Benefits program may very well have been quite different from those under the original FSB during the thick of one of the worst

Table 1: Comparison of New Jobs with Old Jobs after Exhaustion of UI Benefit

Number of Weeks Between Exhaustion and New Job	New Job Compared To Old Job		California		Nevada		New York	
			(%)		(%)			
8	Like:	More	32	79%	32	76%	NA	
		Same	47		44			
		Less	21		24			
	Pay:	More	30	24	NA			
		Same	36	32	56%			
		Less	34	44				
16	Like:	More	34	81%	35	80%	NA	
		Same	47		45			
		Less	19		20			
	Pay:	More	34	30	NA			
		Same	34	32	62%			
		Less	32	38				
24	Like:	More	35	81%	36	80%	<u>26 Weeks After Exhaustion</u>	
		Same	46		44		28	77%
		Less	19		20		49	
	Pay:	More	34	30	28	67%		
		Same	34	32	24			
		Less	32	38	37			

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(Source: Post-exhaustion Surveys, 1973-74, California, Nevada and New York, Unemployment Insurance Service, U.S. Department of Labor, unpublished data.)

Table 2: Comparison of New Jobs with Old Jobs
 - 26th Week after Exhaustion of UI Benefit,
 by Benefit Status - New York.

New Job Compared To Old Job		Those Who Established New Benefit Year (Drew at Least One Benefit Check)		Those Potentially Eligible for Extended Benefits		Those Not Eligible for Additional Benefits	
		(%)		(%)		(%)	
Pay:	More	22	87%	35	68%	29	54%
	Same	<u>65</u>		<u>33</u>		<u>25</u>	
	Less	13		<u>32</u>		<u>46</u>	
Like:	More	15	94%	33	80%	30	72%
	Same	<u>79</u>		<u>47</u>		<u>42</u>	
	Less	6		<u>20</u>		<u>28</u>	

(Source: Post-exhaustion Survey, 1973-74, New York, Unemployment Insurance Service, U.S. Department of Labor, unpublished data)

recessions this country has experienced. One would suspect that the reemployment prospect of these recipients was not very good compared to that of the long-term unemployed workers whose unemployment was of a strictly cyclical nature.

Although the period within which a worker has a reasonable expectation of finding a customary job is a major determinant of UI benefit duration, the idea of "adequate" duration is subject to change over time and varies in different parts of the country. For example, because of structural changes in the U.S. economy, the nature of unemployment may very well have undergone a metamorphosis. With the increasing complexity of production technology together with the wider range of goods and services produced today, a greater tendency exists for occupational specialization. As the degree of specialization increases, the range of workers' adaptability to other occupations narrows. Therefore, once unemployed, many of today's workers may be expected to experience more difficulty finding suitable alternative employment than those in the past unless demand conditions improve rapidly. This implies, therefore, that the duration for which an unemployed worker must search for a "suitable" job has generally increased.

Merging of UI and Other Income Maintenance Goals

The preceding discussion attempted to emphasize that UI is the income maintenance program of experienced workers as distinct from other transfer payment programs aimed at the unexperienced workers or those who are unable to work. However, it is the income maintenance of the unemployed workers after their asking wages begin to fall that leads eventually to the merging of the UI type and the welfare type goals. The relevance of welfare criteria to benefit payments for these workers becomes apparent with respect to both the benefit amount determination and the funding criteria. This conclusion can be explained as follows:

(1) The fact that a worker is willing to accept wages lower than the formerly accustomed wages implies that he/she is modifying the standard of living. It, then, really would not make sense to gear the determination of the WBA to the former standard of living when the worker himself/herself concedes that such level of living is no longer attainable. The adherence of the program to such a rigid criterion is apt to produce adverse consequences. The implied support of the workers' artificial aspiration of being able to return to the former level of work will only perpetuate their failure to secure employment and, hence, create an undue pressure on UI financing. Also, the illusion of a higher standard of living than attainable would merely encourage the workers to postpone job acceptance decisions, thus resulting in a waste of productive human resources.

It can be argued that at this stage of unemployment, any income maintenance of experienced workers should be geared to that wage level which is actually attainable at the present time rather than in the past. As these wage levels are likely to be changeable from one week to the next, one can argue that the benefit amount itself should be made flexible over time. The resulting "unemployment" benefit for income maintenance purposes gradually shifts away from the income protection in the traditional UI sense. The WBA's would be in proportion to the currently acceptable wages, hence a departure from the UI principle of partially replacing the past wages, but still would have little to do with the welfare goal of guaranteeing subsistence. The transition of the UI type income maintenance over time to the welfare type income maintenance is clearer in an instance where the proportion of "acceptable" wages replaced by the WBA falls to or below a level sufficient for subsistence when combined with any other family income. Clearly, the level sufficient for subsistence is the minimum level to which the WBA is allowed to fall and which should be guarded by social policy, and to guarantee this is the welfare goal.

(2) The loss incurred in the process of workers' downward adjustment of their living standard in this stage of unemployment is not as severe as it is at the beginning of unemployment. As discussed earlier, much of the difficulty in attempting to adjust to the lower level of living at the outset of joblessness stems from the fact that fixed investments cannot readily be scaled down without incurring a heavy loss. At the same time, many of these investments do depreciate over time; and, it is easier to dispose of them or switch them for other types of investments if sufficient time is allowed. For these reasons, the downward adjustment of the living standard after extended unemployment should be considerably less painful than at the outset of unemployment.

(3) Whether and to what extent unemployment insurance should pay the benefit at any point of time in the course of a worker's unemployment must depend on the cause of unemployment in this particular week. In other words, the cause of the incidence of unemployment must be distinguished from the cause of continued unemployment. The former determines whether an individual can start receiving UI benefits while the latter determines his/her eligibility for each subsequent week.

Underlying Policy Issues

The preceding discussion points to the increasing difficulty of regarding prolonged unemployment as "insurable" in the same sense as the incidence of involuntary unemployment. Such a concern is especially pertinent with respect to the joblessness of those who exhaust their regular unemployment benefits at the maximum potential duration, generally 26 weeks, and continue to be unemployed. In the recent recession of 1975 and 1976, such exhaustees were among the recipients of Federal Supplemental Benefits (FSB) which, together with the regular UI and State extended benefits, provided a maximum of 65 weeks of protection at the same weekly benefit amount.

While in most cases the changing employability of an unemployed worker is a gradual and continuous process, for policy purposes the span of a jobless period may be broken into three distinct phases either for each individual beneficiary or for a group of beneficiaries. The first phase would consist of weeks during which the changes in the beneficiaries' employability are nil or very little. This is the period for which unemployment insurance benefits are applicable in the traditional sense. The second phase is the period during which the beneficiaries' employability discernibly declines for one or more reasons. This is the period in which a combination of the UI type income support criterion and the welfare type income support criterion eventually would merge, with the latter growing in its prominence as a beneficiary's joblessness persists. Also, in this phase, measures of labor market policies become increasingly useful. The third phase represents the period in which a beneficiary may become totally unemployable regardless of the amount of job search assistance provided. Age may be an example of a contributing factor to this state. This would be the period outside of the scope of the policies aimed at the workers' employment security, which is the fundamental goal of the unemployment insurance program.

Given this conceptual phasing of the beneficiaries' jobless period, the following policy issues emerge:

How should the length of the first phase be determined?

What appropriate policies should be taken in response to the changing employability of beneficiaries in the second phase?

If benefits are to be paid in the second phase, what should be the weekly amounts and for what duration?

What should be the eligibility criteria for the second phase benefits?

What mechanism should be set up for early detection of declining employability?

What specific services should be provided to beneficiaries in the second phase to expedite their obtaining "suitable" jobs?

How should the second phase unemployment benefits be financed?

What can be done about the income support of people in the third phase?

Some of the issues are discussed below:

1. Length of the First Phase

Although for some workers, especially the structurally unemployed workers, erosion of their re-employment prospect begins immediately upon the onset of joblessness, for many a discernible extent of it takes effect only after a certain length of unemployment. Payment of unemployment insurance benefits in the first phase of joblessness, therefore, seems most in accord with the basic objective of UI to protect the customary

standard of living while workers are temporarily unemployed and, more importantly, upon their regaining employment. It is also in conformity with the present experience-rated employer tax financing of UI benefits in the sense that, in this period, the main factor in beneficiaries' joblessness is demand related--the basis for employer charging of benefits. Beyond this first phase, the supply characteristics of individual claimants become increasingly important in explaining their continued unemployment. This fact makes it inequitable to keep holding employers responsible for their former employees' joblessness.

The following sub-issues are pertinent:

a. Is the length of the first phase unemployment variable among individual beneficiaries at a given time?

As discussed in a previous section, many states now have variable duration of UI benefits. In these states, the benefit duration is geared to the beneficiaries' current labor force attachment measured by their past employment experience. In other words, how long a claimant may receive unemployment benefits is determined by past experience and not by how long he/she may undergo joblessness which is to be compensated by the UI benefits under the criteria of sufficient labor force attachment and reasonable prospect of finding "suitable" jobs.

The prospect for finding jobs is not only a function of the conditions of aggregate demand and supply of labor, that affect all workers, but also a function of individual beneficiaries' unique labor market characteristics. These latter include geographical mobility, skill and occupation levels, industry attachment, age and other personal characteristics. Thus, it is reasonable to expect that the length of the first phase unemployment is uniquely determined for each beneficiary by the specific mix of these factors; and, the greater the variability with respect to these factors, the greater the individual variation in the length of the first phase.

On this basis, then, as long as benefit costs are tied to employer tax rates, an argument can be made to make the permanent duration of UI benefits variable according to these relevant factors. If not, at the least, there is a strong justification to classify claimants in the first phase and tailor specialized labor market assistance to each group.

b. Does the average length of the first phase unemployment change over time?

While the changes in economic and demographic conditions can alter the average length of the first phase secularly and cyclically, perhaps the most important implication of this question is the way the cyclically long-term unemployment should be treated by unemployment insurance. Given the UI goal of providing benefits during the "temporary" period of joblessness, if the "temporary" period changes over time, the question of changing the potential benefit duration must logically follow. In the context of UI, it must be reasonable to view the "temporary" period as the period in which a re-employable worker can find a "suitable" job as defined under the UI provisions--i.e., the first phase. Obviously, the ease or the difficulty of finding a suitable job depends on how many people with the same skill are available for work and on how many people are needed. Focusing on the latter aspect, the cyclical changes in aggregate demand give rise to cyclically changing ease in finding employment for workers. Thus, the cyclical changes in definition of the "temporary" period occur concomitantly. Over a long-run, changes in "temporary" period may occur due to the secular changes in the structure of the economy that make it increasingly difficult to find jobs once one is out of work. In either case, therefore, arguments can be made for a flexible permanent duration of regular state UI benefits in the light of what UI is intended to do. Such flexibility of the first phase UI benefit together with the provision for some unemployment benefits for the second phase unemployment would obviate the need for special extensions of UI benefits in each recessionary period as made several times in the past. To be noted, however, is that the second phase benefits would be

different from the benefits in the first phase in their objectives and, quite possibly, in the appropriate funding source. This point will be touched upon later.

c. Does the length of the first phase unemployment vary geographically?

Locational characteristics, unique resource endowments and even the specific demographic composition, especially in the short-run, determine the industry mix of a state or a local area. This, in turn, creates the varying vulnerability of a state or local economy to the changes in general economic conditions. Thus, it is expected that, on the one hand, the cyclically unemployed workers of some states or areas have longer to return to their accustomed work than those in other states or areas because of the inherent nature of the particular industry mix and, on the other hand, the workers in the states or areas with a predominance of declining industries face, once unemployed, an early deterioration of their employability. The former implies longer first phase unemployment on the average in states or areas with cyclically sensitive industries than in others, and the latter implies shorter first phase and quite possibly longer second phase unemployment for workers in states and areas with secularly declining industries.

From the standpoint of the UI objective, varying the permanent benefit duration by states or even by local areas is reasonable, on this basis, since a geographical variation in the definition of a "short" period of unemployment is just as real, and the question as relevant, as the variation over time. Thus, if the cyclical trough affects one labor market more severely than it does others, thus making the "short" period there longer than that in others, the benefit duration, it can be argued, should be longer for the common purpose of "tiding the unemployed workers over a short period of joblessness."

2. Appropriate Policies for the Second Phase

The second phase unemployment is characterized by the discernible tendency for the beneficiaries' employability to decline. Thus, for any one week in that phase, joblessness is explained partly by lack of demand and partly by the beneficiaries' characteristics that hinder re-employment. As unemployment persists, the latter increases in its importance relative to the former. In this phase of unemployment, pursuing the UI objective of helping workers maintain their customary standard of living, with the direct weekly benefits while unemployed and by working at a "suitable" job when re-employed, would only be partially attained without some measures to shore-up the beneficiaries' employability.

The benefit payment in this phase would have two components -- namely, (a) income support for maintenance comparable to the benefits in the first phase and (b) expense need for intensive job search and retraining. Determination of weekly benefit amounts to be paid in this phase should take into account the changes in these components.

Preservation of the customary standard of living as the ultimate UI policy goal needs to be conditioned by the possibility that eventually the beneficiaries can sustain such standard when re-employed. When re-employment in accustomed work is no longer possible, as premised in the second phase in the absence of additional labor market assistance, it seems reasonable to scale the weekly benefits, not along the beneficiaries' customary standard of living, but along the level of living that they can expect to achieve. With diminishing employability, the resulting weekly amount corresponding to the first component, therefore, would be smaller than in the first phase.

The other aspect of the problem to be considered is that, with the increased erosion of employability, increased intensity of job search is required for each

beneficiary for each week if he/she is to regain the accustomed employment (i.e., suitable work relevant in the first phase). Therefore, if, on the one hand, the weekly benefit for income support purposes may decline because of the diminishing employment potential and consequent declining attainable wages, on the other hand, the job search cost need rises concurrently. With the ultimate social goal of minimizing the loss of productive skills and of minimizing the hardship of career disruption, therefore, there is a basis for arguing for the continued payment of weekly benefits after the first phase in similar amount in order to shore-up eroding employability.

3. Financing the Benefits for the Long-Term Unemployed

There are two basic questions that arise in connection with the financing of unemployment benefits for unemployed workers in the second phase joblessness-- i.e., "long-term" unemployed. They are: (a) What should be the source(s) of funding? (b) How should the charging of benefit costs be made to the fund source(s)?

Assuming that the principle of employer tax financing is retained to pay for the benefit costs of the employer performance related unemployment, in the process of gradual decline of individual beneficiaries' employability in the second phase, an argument can be made for financing the benefits for each week of unemployment partially from the same source of funding. This is because the unemployed status over and above that attributable to the eroded employability remains similar in nature to the first phase unemployment. The real or imagined erosion of productivity due to non-use of labor is not caused by the performance or actions of any one employer. Therefore, there is reason to consider paying part of the weekly amount from a pooled fund of employer tax payments, similar to the present non-charged benefits, or from the general revenue fund.

Summary and Conclusion

This paper attempted to differentiate the rationale of unemployment insurance type income maintenance from that of welfare type income maintenance. The crucial difference between the two is that unemployment insurance targets at protecting the workers' customary standards of living while the central focus of welfare programs is attaining the minimum socially acceptable level of living for those unable to do so on their own. These are distinct, and obviously equally important, goals of the transfer programs.

This paper also pointed out that, with the passage of time during a beneficiary's period of unemployment, the nature of his/her unemployment and his/her labor supply characteristics may change. The resulting increase in the difficulty of finding jobs paying wages comparable to the previous wages and the consequent tendency to accept lowering the level of living create two counter forces--namely, increased financial need for job search purposes and reduced living expense need. The result may be that the same amount of benefit as at the outset of unemployment is needed to maximize the chance of eventually assuring beneficiaries' job security without a drastic disruption of their level of living. However, the changing characteristics of the claimant or economic conditions over time makes the traditional goal of unemployment insurance less and less appropriate.

Since the existing UI financing structure is an integral part of the system based on the specific understanding of the nature of unemployment to be compensated by UI benefits, the benefit payments to workers whose joblessness is different from that envisioned in the original UI goal necessitates re-thinking of the financing scheme itself.

The entire issue of the gradual merging of UI type income maintenance with welfare type income maintenance goals as the unemployment of the beneficiaries continues leads to an important UI issue of the adequacy of benefit duration. Once the adequate unemployment insurance duration is decided upon for any group of unemployed workers, the method of financing benefits for the subsequent period can be identified.

In the final analysis, what the society needs is income security through job security for all able workers. Unemployment insurance is merely a temporary stop gap measure for those whose careers are disrupted. Thus, for those who are working, we want to do our best to prevent them from being displaced. For those who are displaced, we wish to provide protection to minimize hardship. And, for those who continue to be jobless and tend to be disadvantaged in the job market, we want to help restore their ability to participate in the labor market. Let me conclude by expanding on these points:

1. Need for Preventive Labor Market Policy

The best income maintenance policy is to keep employed workers on the job without interruption by unemployment. Given, however, the dynamic nature of our economy, structural displacement is a constant threat to any segment of the work force. In order to minimize the actual joblessness due to this cause, aggressive preventive measures should be taken at all times. They would include (a) constant assessment of the future performance of industries to pinpoint potential trouble spots as well as promising sectors and forecasting the demand for labor by industry and occupation, (b) dissemination of information on the future demand for labor and early warning for potentially soft sectors, (c) assistance to employers (firms) in the potentially declining sectors in finding ways to improve competitiveness or to shift production to developing areas in order to forestall eventual shut-down,

(d) job counseling, retraining, employment service and other labor mobility aids to assist potentially vulnerable workers to make the transition as smooth as possible and (e) in firms and industries where eventual curtailment of their operation is inevitable, a work sharing scheme to soften the effect of lay-offs and/or to provide workers time and financial resource, while employed, to engage in job search activities or retraining. The emphasis of a preventive labor market policy is on the continuity of employment for workers; therefore, the approach really needed is a long-range view of the whole economy with long-run planning of individual firms to fit in this total picture. Thus, the implied adjustments required may include changes in firms' products and occupational mix. Obviously, a satisfactory result will call for the full understanding and cooperation of management, workers and the administering governmental agencies where government programs are involved.

2. Adequate Duration of Regular Unemployment Insurance Benefits

Unemployment insurance payments per se must be clearly distinguished from payments not chargeable to employer accounts, as long as the present financing scheme prevails. Thus, aside from the constraint imposed by actuarial considerations, the proper duration of unemployment insurance payments should be determined strictly by the weight of the employer performance related unemployment for each week of benefits claimed. The changing character of the economy and population may have induced a lengthening or shortening of the average duration of employer performance related unemployment over time. Thus, there is a need for an on-going indepth analysis of what constitutes adequate benefit duration.

3. Unemployment Compensation for the Long-term Unemployed

The income maintenance need for workers with an extended period of unemployment is real. If failure

to find desired work persists, it is likely to produce a reduced income requirement. Thus, with the wage loss replacement principle, the income maintenance portion of the unemployment benefit to these long-term unemployed workers, if it is to be paid, is likely to be smaller than that of the regular UI benefit; however, since the long-term unemployed are at a steadily increasing disadvantage in securing reemployment, compensating payments to aid in job search expenses may be desirable. On balance, therefore, there is rationale for a weekly benefit amount for the extended benefit just as large as that for the regular UI payment. The continued payment of a weekly benefit amount based on this rationale calls for a careful application of the so-called work test in order to ensure that the beneficiaries are "able and willing" to work. This must be accompanied by an aggressive job search assistance program by the government agencies. The importance of the individualized job search assistance programs such as the one now under experimentation called the Eligibility Review Program (though this name carries an unfortunately negative connotation) is obvious.

On the financing side, since factors other than those which prompted the initial displacement become more and more prominent in explaining the state of unemployment among these long-term unemployed workers, there is a strong argument for financing an increasing portion of extended benefits through general revenue funding. For this reason, extended benefits should be regarded as unemployment compensation distinct from unemployment insurance.

4. Labor Market Policy for Long-Term Unemployed

The payment of an extended benefit to the long-term unemployed must be accompanied by an aggressive labor market policy of retraining, employment counseling and referral and even relocation assistance. While individual workers can conduct job search on their own through friends and relatives and through advertisements, their search horizon is likely to be limited. Taking

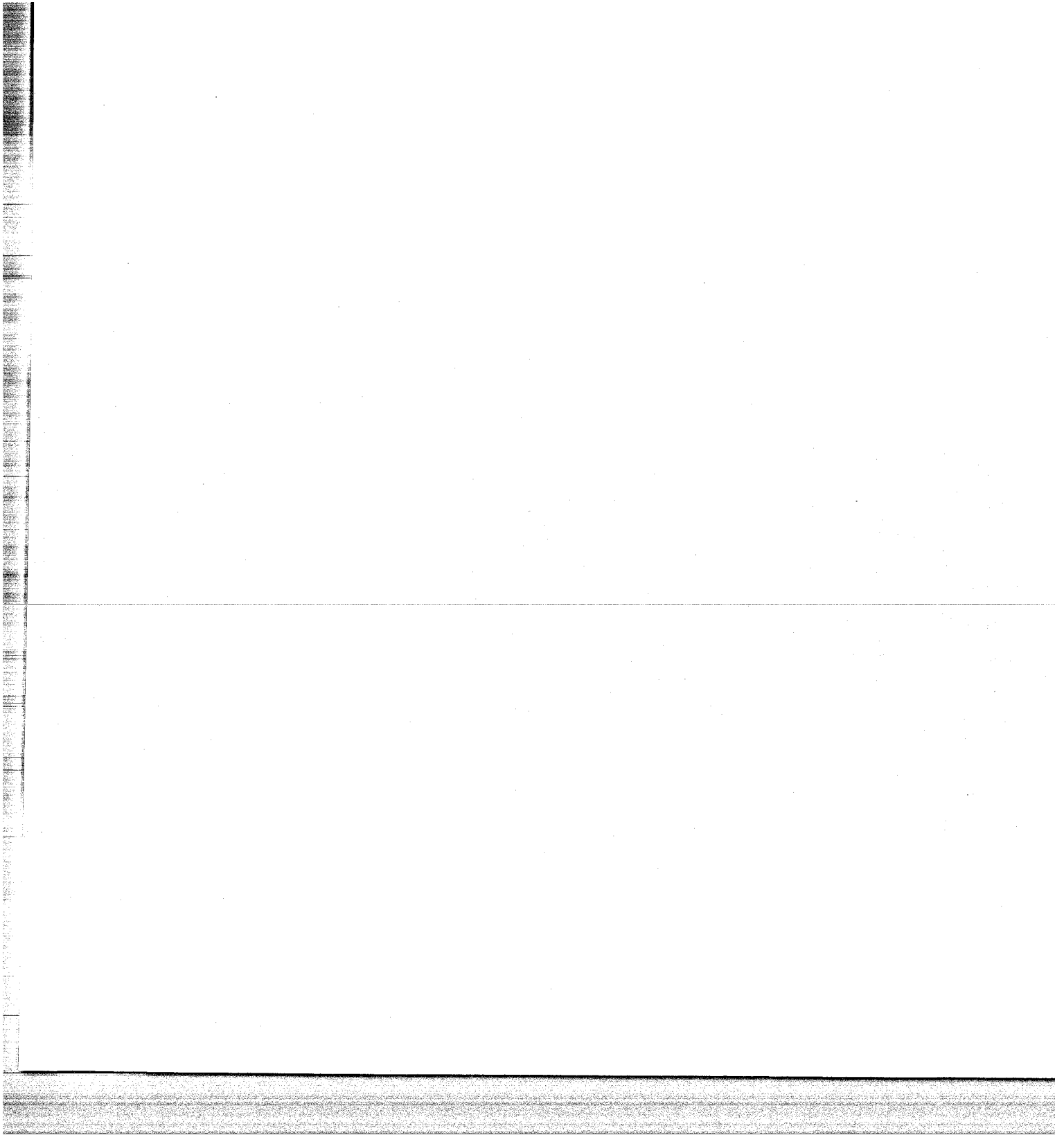
advantage of the scale economy, a governmental body can immensely enhance the reemployment opportunity of these workers. As a concrete measure, perhaps, we need to reassess the functions of the United States Employment Service vis-a-vis the role of the Unemployment Insurance Service and/or the policy goals of the Employment Service itself. The ultimate goal of society must be to find jobs for all able and willing workers; therefore, the payment of unemployment benefits, be it regular UI or extended benefits, must be in conjunction with an intensive effort to find jobs for the recipients. Only then do we have an integral program of income maintenance as conceived by the intent of UI type income maintenance.

When the income security of experienced workers is achieved through unemployment benefits in conjunction with an active labor market policy, the loss in the workers' overall well-being due to the inevitable recurrent unemployment problems is minimized. Unemployment insurance, then, is the complement to welfare programs which focus on the other aspect of the income maintenance problem.

Footnotes

- 1/ Actually, the number of UI claimants who receive any type of welfare benefits, before or while receiving UI benefits, or after exhaustion of UI benefits, has typically been very small. For example, a survey of claimants of Federal Supplemental Benefits (FSB) found that 4 percent and 5.5 percent of the households of the non-exhaustees and the exhaustees respectively, of FSB benefits, received some kind of welfare benefit while receiving unemployment benefits. The corresponding figures for receipt of welfare benefits after collecting FSB benefits were 8.4 percent and 6.9 percent.
- 2/ The wage and duration figures used here are actually the 1977 average weekly wages in the UI covered establishments, and the 1977 average UI claims duration for the U.S.
- 3/ Base period is generally defined as the first four of the five quarters just preceding the filing of a UI claim.
- 4/ There is a variation in the minimum number of days which must be worked in a week for the week to be counted as actually worked.
- 5/ With the exception of West Virginia, in which the benefits can be as low as .8 percent of annual wages as of 1977.
- 6/ In light of the income maintenance objective of UI, whether the 50 percent wage loss replacement principle and the existing maximum weekly benefit amount really fulfill such objective is the crux of the traditional benefit adequacy issue.
- 7/ Significant Provisions of State Unemployment Insurance Laws, January 1, 1979, Unemployment Insurance Service, United States Department of Labor.
- 8/ op. cit.

- 9/ In Alabama, Alaska and New Jersey, employee contributions supplement the employer tax funding either at all times (Alaska and New Jersey) or when the fund falls below a certain minimum (Alabama).
- 10/ Italy is the only other country where the funding is solely by employer tax. See, Saul J. Blaustein and Isabel Craig, An International Review of Unemployment Insurance Schemes, Table 9, pp. 105-109. (The W.F. Upjohn Institute for Employment Research, 1977).
- 11/ This is a rough statement of the general principle. There are four specific methods by which the experience rating is done--namely, Reserve Ratio Formula, Benefit Ratio Formula, Benefit-Wage Ratio Formula and Payroll Variation Plan. Of these, the Payroll Variation Plan deviates somewhat from this principle. For details for these formulas, see Comparison of State Unemployment Insurance Laws, (U.S. Department of Labor, 1978), pp. 2-5 and 2-6.
- 12/ Post-Exhaustion Surveys, 1973-1974, California, Nevada and New York. Unpublished data for Unemployment Insurance Service, United States Department of Labor.
- 13/ Exactly who ends up bearing the tax burden of any payroll tax and how much is borne by anyone depends on the structure of markets an employer faces both in selling his product and in buying productive resources. This problem is made complex in the unemployment insurance area by the variation in benefits received among the employees of different firms. Thus, it is a gross simplification to say that the employers assume the full tax burden.
- 14/ Public Law 94-566, 94th Congress.



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