UNEMPLOYMENT COMPENSATION:

A BACKGROUND REPORT

Background Paper No. 15
December 8, 1976

CONGRESS OF THE UNITED STATES
Congressional Budget Office
Washington, D.C.

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $1.20

PREFACE

This report is one of a continuing series of reports on unemployment and employment policies issued by the Congressional Budget Office. It was undertaken at the request of Representative Parren J. Mitchell, Chairman of the Human Resource Task Force of the House Committee on the Budget. In keeping with the Congressional Budget Office's mandate to provide nonpartisan analysis of policy options, it contains no recommendations.

The report was prepared by T. Wendell Butler, Marc Freiman, Richard Hobbie and David Mundel of the Congressional Budget Office, Human Resources and Community Development Division, with the assistance of Alan Fein and Katharine Bateman.

Alice M. Rivlin
Director

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

77-207 O - 76 - 2

SUMMARY

The current severe economic conditions have produced a dramatic increase in unemployment compensation benefit payments--from $7 billion in calendar year 1974 to an estimated $19 billion in fiscal year 1976. At the same time, unemployment compensation system revenues have only increased from about $6.5 billion to $7.5 billion. The obvious result has been a serious drain on state trust fund reserves and a greatly expanded use of general revenue federal funds.

The current situation has therefore prompted a reexamination of the structure and goals of the unemployment compensation system. This system provides benefits primarily to those previously employed individuals who did not voluntarily leave their jobs. This group comprised approximately 50 percent of the unemployed in October 1976. The maximum potential benefit duration for eligible persons under the permanent program is usually 26 weeks, and is financed by a tax on payrolls of employers in covered industries.

There is a tendency for the unemployment compensation system to become financially unbalanced over time, because the taxable wage base has a ceiling but benefits increase automatically with wage increases. Legislated increases in the taxable wage base and/or the payroll tax rate will restore a balance between revenues and benefit payments, but only temporarily. Making the system self-financing over the long run would require either periodic legislated increases in the taxable wage base or a system of automatic adjustments.

In addition to the basic 26-week program, there are two temporary programs (Extended Benefits and Federal Supplemental Benefits) which lengthen the maximum potential duration of benefits to 65 weeks. Currently, these programs are primarily financed by repayable advances from general federal funds. Repayment of these advances will take years, even with the substantial increases in payroll taxes projected for the future. Also, these programs are "triggered" into effect when unemployment rates rise to high enough levels. As our economy slowly recovers, these programs will trigger off. This likelihood has led to an examination of the reliability and equity effects of the trigger mechanisms currently in use.

Currently, most agricultural and domestic workers and state and local government employees are covered by a temporary program called Special Unemployment Assistance (SUA), which is supported by general federal funds. Legislation was recently enacted which will include these workers in the permanent coverage of the regular

unemployment compensation system.[1] There is a question about whether the contributions of these workers to the regular trust fund system will match the level of benefits that they are expected to draw. However, it should be noted that, under the current system in some states, industries such as construction already receive more benefits than they contribute in employer payroll taxes.

Unemployment compensation benefits (which are not taxable) replace, on average, between 50 and 60 percent of a worker's after-tax income. However, this result does not take into account the effects of fringe benefits or work-related expenses on this net wage replacement rate, nor does it include other income assistance benefits such as food stamps, which the unemployed may receive.

Due to data limitations, it is difficult to produce accurate estimates of the effects of the existing unemployment compensation programs on work incentives and employer behavior. However, a good estimate produced in this difficult area of research is that the current 26-week program adds approximately 0.3 percentage points to the unemployment rate during times of relative prosperity. Proposals to set national benefit standards (as opposed to the current system of many state-level standards) would raise the average benefit level, and therefore may increase these work disincentive effects.

The goals of the unemployment compensation system are also currently undergoing reexamination. The following three sets of changes to the system illustrate _extreme_ forms of alternative strategies and their general effects. They are _not_ intended to suggest final outcomes, but they are overall directions that could influence specific incremental program decisions.

1. Make the system self-financing and cover only those sectors having generally lower and more predictable unemployment by eliminating the extended duration programs and by increasing payroll taxes. This system would increase direct employer-employee costs, but would practically eliminate the need for general federal funds. It would decrease slightly the work disincentive effects as a result of the decreased financial support for the unemployed.

2. Broaden the system into a special noncontributory income assistance program for previously employed workers in all industries and support it entirely by general federal

---

1. See Appendix D for a description of the major provisions of the new law.

funds. This substantial increase in the use of general funds would be accompanied by an improvement in the condition of the unemployed who were previously uncovered, and consequently by greater work disincentive effects for these groups.

3. Eliminate the unemployment compensation system and rely on other income assistance programs. Dismantling the system would substantially worsen the condition of the unemployed, because many unemployment compensation recipients would either be ineligible for other forms of income assistance or would receive lower payments. Consequently, all government spending needs for this group would be substantially reduced, as would work disincentives.

The current unemployment compensation program structure represents a combination of these approaches. The basic system is self-financing, with limited coverage. However, in times of severe and general economic hardship, general federal funds are used in the system in large quantity, and both coverage and duration of benefits are extended.

The recently enacted changes in the unemployment compensation system also embody elements of the three approaches. The review of knowledge about the system contained in this report provides an understanding of these recent changes as well as changes that may be proposed in the future.

CHAPTER I

UNEMPLOYMENT COMPENSATION

Overview of the Policy Discussions

Unemployment is a continuing national concern. During the recent recession, the unemployment rate rose as high as 8.9 percent (May 1975), with 8.5 million workers unemployed. Since then the economy has experienced a gradual recovery, with the unemployment rate standing at 7.9 percent during October 1976.

The unemployment compensation system is one of society's major efforts at dealing with the problems of unemployment. 1/ The depth of the recent recession and the recovery now under way have combined to focus attention on almost all the important features of the system. The huge increase in total system outlays (from $6.5 billion in fiscal year 1974 to $20 billion in fiscal year 1976) has necessitated a great deal of borrowing from general revenues and has raised questions about the adequacy of the trust fund financing. 2/

During the recent recession a temporary program was enacted which expanded the coverage of the unemployment compensation system. Subsequent interest was directed at the feasibility of including the newly covered groups in the permanent system. This goal was largely accomplished in the recently enacted law (P.L. 94-566) described in Appendix D.

As might be expected, the high unemployment rates and the concomitant levels of unemployment compensation claims have put a great strain on the administrative apparatuses of both the unemployment insurance service and the employment service. Interest has therefore arisen in finding ways to make the combined services more efficient in responding to cyclical changes in the economy.

The current cyclical recovery has also directed attention at the mechanism by which temporary programs, which provide a longer duration of benefits, are triggered into effect. And finally, now that there are increasing opportunities for employment, the work disincentive effects of unemployment compensation and variations in payment levels from state to state are both being reexamined.

---

1. Other approaches used by the government are monetary and fiscal policy programs targeted at employment of specific groups, education and training programs, and various income assistance programs.

2. This $20 billion figure includes both benefit payments _and_ administrative costs.

Overview of the Unemployment Compensation System

The unemployment compensation system originated with the Social Security Act of 1935. Its history is one of federal-state interaction and cooperation. During the debates prior to establishment of the system, one of the key issues facing the Congress was whether to have a uniform federal program or to allow each state to develop its own program. A federal-state system was chosen to enable the unemployment conpensation system to adapt to the nation's heterogeneous economy.

In the early 1970s, the unemployment compensation system was fairly straightforward. State and federal employer payroll taxes funded a permanent benefit program and a "triggered" extended benefit program (which only comes into operation when national and state unemployment rates reach certain levels). The state taxes first flowed into separate state trust funds (plus separate funds for the District of Columbia and Puerto Rico) and the federal taxes flowed into a set of federal unemployment (FUTA) accounts. These FUTA accounts also paid for the costs of program administration. This flow of funds is depicted in Figure 1. (The state trust funds and the federal accounts are collectively called the Unemployment Trust Fund.)

However, the unemployment compensation system is no longer quite so straightforward. In reaction to recent high unemployment rates, the Congress has passed a variety of temporary unemployment compensation programs. The current set of programs for which various individuals may be eligible is described in Figure 2. The regular permanent program provides a maximum duration of 26 weeks of benefits. Not all workers receive the maximum duration, since the duration of benefits depends on the individual's work history.

The extended benefits (EB) program, also a permanent component of the system, was established in 1970 by the Federal-State Extended Unemployment Conpensation Act (P.L. 91-373). When triggered on by high national or state unemployment rates, this program provides up to 13 weeks of additional benefits to workers who have exhausted their regular benefits. The federal supplemental benefits (FSB) program provides up to a maximum of 26 weeks in further benefits to persons who have exhausted extended benefits. (When established in 1974, the program provided only 13 weeks of additional benefits. However, this was increased to 26 weeks as part of the Tax Reduction Act of 1975.) FSB is a temporary triggered program, and it will expire in March 1977.

77-207 O - 76 - 3

FIGURE 1:
UNEMPLOYMENT COMPENSATION FLOW OF FUNDS

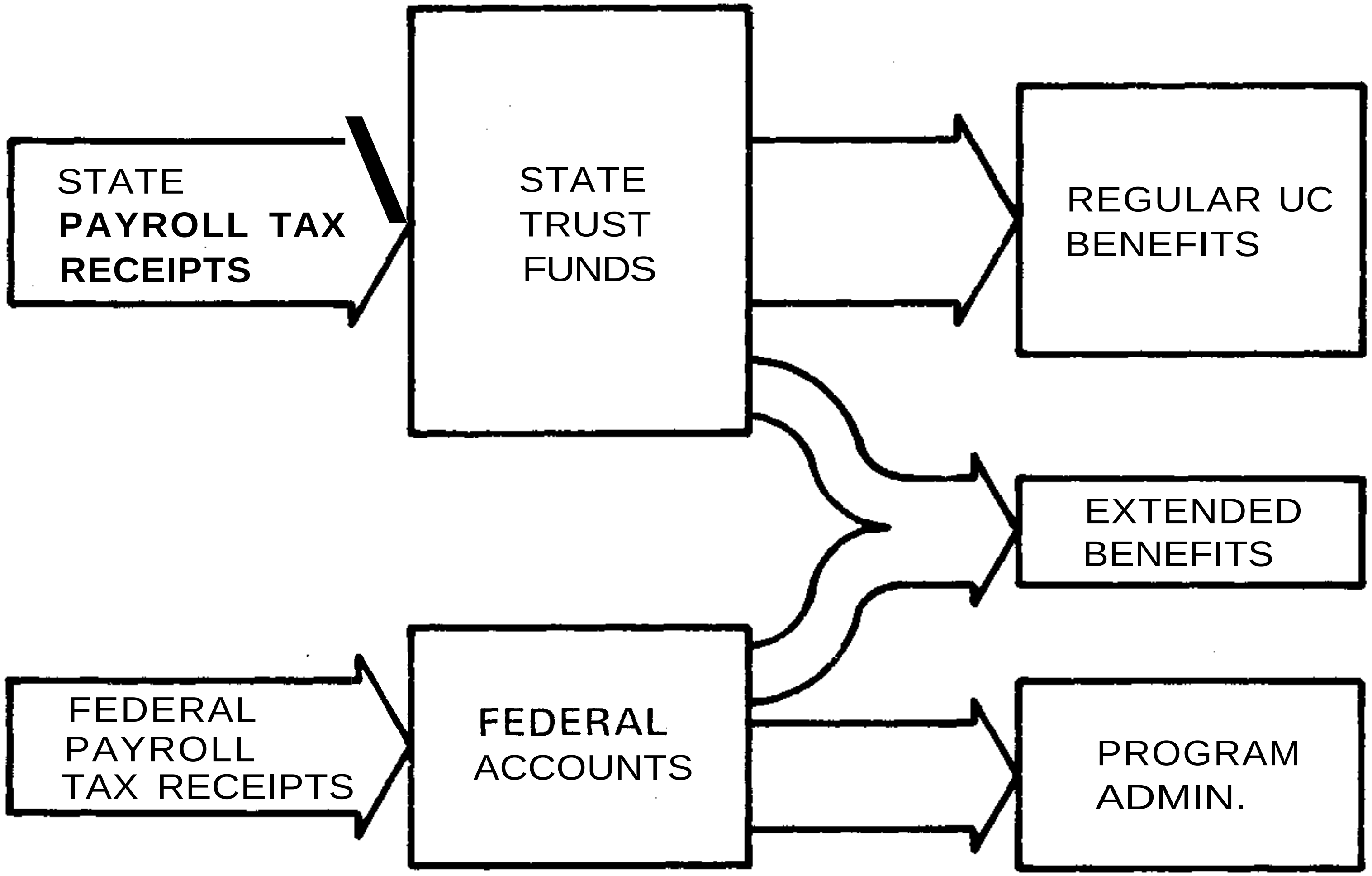


FIGURE 2: CHARACTERISTICS OF UNEMPLOYMENT COMPENSATION PROGRAMS

PROGRAM	COMMENTS	MAXIMUM DURATION OF BENEFITS* (WEEKS)	BENEFIT COSTS FY 1976 (ESTIMATE) $ BILLIONS	PROGRAM EXPIRATION DATE	IS PROGRAM TRIGGERED ON BY UNEMPLOYMENT RATES?	NUMBER OF RECIPIENTS (CY 1975) MILLIONS
REGULAR BENEFITS		26	10.8	PERMANENT	NO	12.2
EXTENDED BENEFITS (EB)	AVAILABLE TO WORKERS WHO HAVE EXHAUSTED REGULAR BENEFITS	13	2.4	PERMANENT	YES	4.3
FEDERAL SUPPLEMENTAL BENEFITS (FSB)	AVAILABLE TO WORKERS WHO HAVE EXHAUSTED EXTENDED BENEFITS	26	2.6	MARCH 1977	YES	2.1
SPECIAL UNEMPLOYMENT ASSISTANCE (SUA)	AVAILABLE TO WORKERS IN INDUSTRIES NOT COVERED BY REGULAR UC PROGRAM, BUT WHO COULD OTHERWISE BE ELIGIBLE FOR BENEFITS. PREDOMINANTLY STATE AND LOCAL GOV'T. EMPLOYEES, AGRICULTURAL AND DOMESTIC WORKERS.	39	0.9	MARCH 1978	YES	1.2

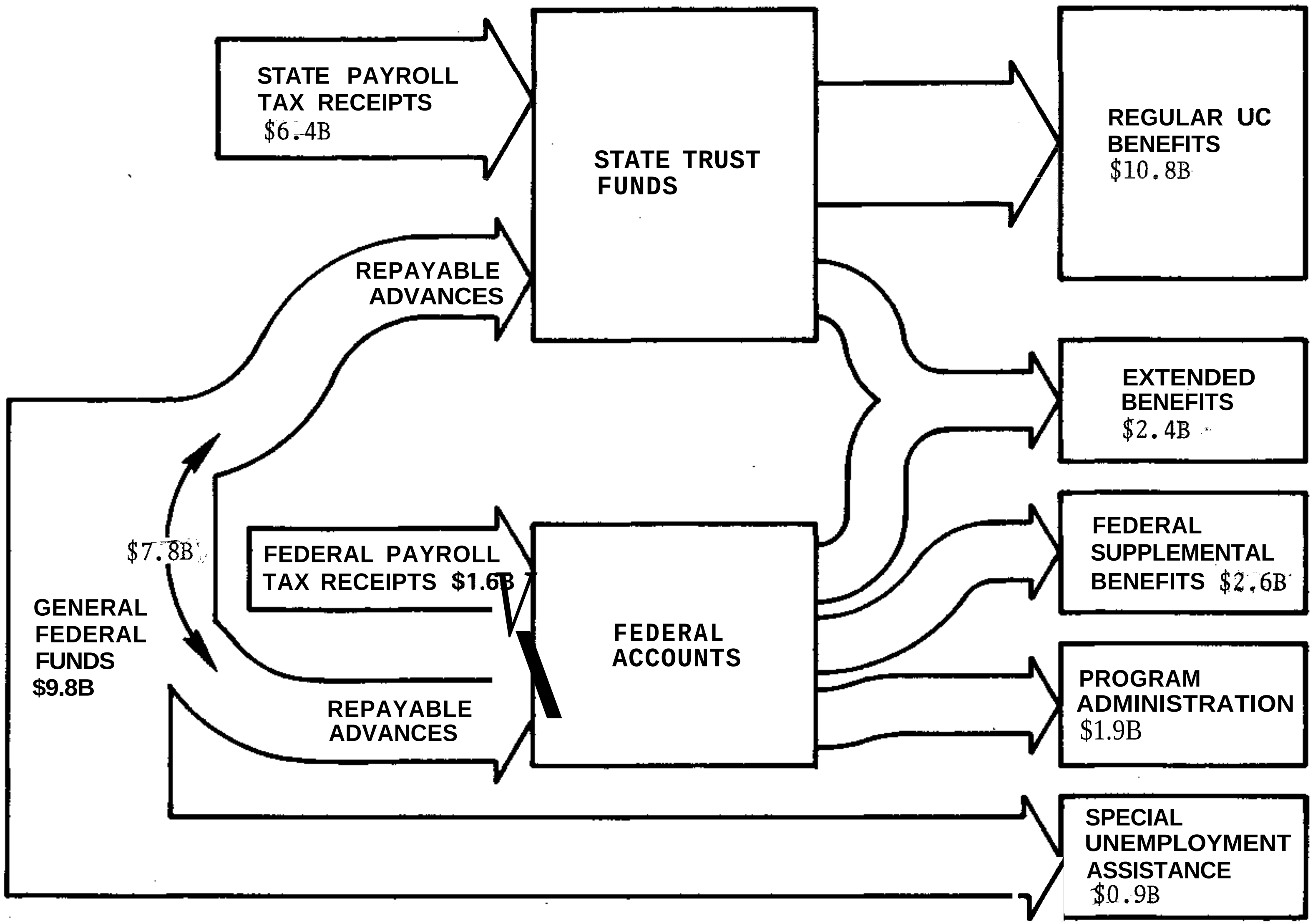
*ALL WORKERS NOT NECESSARILY ELIGIBLE FOR MAXIMUM DURATION.

The cumulative result of all the above programs is that an unemployed individual may be eligible for a potential maximum of 65 weeks of benefits.

The special unemployment assistance (SUA) program was established in 1974 by the Emergency Jobs and Unemployment Assistance Act. It provides up to 39 weeks of benefits to workers in industries not covered by the regular unemployment compensation system, but who would otherwise be eligible for benefits on the basis of their work history. The major groups covered by this program are state and local government employees and agricultural and domestic workers. The SUA program will also expire in March 1978.

Due to this proliferation of programs and high unemployment rates, benefit payments have jumped from $6 billion in 1974 to $14 billion in 1975 to an estimated $19 billion in 1976. At the same time, payroll tax receipts have risen only slightly (from $6.8 billion in 1974 to $8 billion in 1976). The result has been an increasingly large need for repayable advances to the Unemployment Trust Fund from general revenues, and outright federal funding. The flow of funds has also become more complex, as is illustrated in Figure 3.

FIGURE 3: FLOW OF FUNDS IN FY 1976



Note: Outlays do not equal receipts due to drawing down of trust fund reserves.

CHAPTER II

FINANCING THE PROGRAM

Background

The basic unemployment compensation system is financed by two payroll taxes. Both the federal and state governments levy a tax on an employer's taxable payroll. The taxable payroll is defined as total wages up to $4,200 paid to each employee per year. 3/

The Federal Tax

The Federal Unemployment Tax Act (FUTA) established a tax of 3.2 percent on taxable payrolls. However, the tax is reduced by 2.7 percent for employers in states with approved unemployment compensation programs. Since all states have federally approved programs, an employer's effective federal tax rate is only 0.5 percent. Effective January 1, 1977, this rate will rise to 0.7 percent and remain there until all loans to the EUCA acccount have been repaid. (See pages 11 and 12.)

The State Tax

State programs have varying tax rate schedules. Unlike the constant federal tax rate of 0.5 percent, all state programs except Puerto Rico utilize an experience rating system, which varies an employer's tax rate on the basis of his employees' receipt of benefits. This system penalizes employers whose employees experience high levels of unemployment by imposing higher tax rates on their taxable payrolls, up to a maximum tax rate established by each state.

Under federal law, states may have minimum tax rates as small as zero. Six states have minimum tax rates of zero. Federal law also requires that states have a maximum tax rate of at least 2.7 percent. Most states have a higher maximum and the highest is 6.6 percent. The average state tax rate is about 2.0 percent. Table 1 presents the minimum, average, and maximum tax rates in the 50 states, the District of Columbia, and Puerto Rico.

---

3. Ten states have instituted wage bases higher than $4,200. On January 1, 1978, the federal taxable wage base will rise to $6,000.

TABLE 1--STATE TAX RATES (1974)

State	Minimum	Average	Maximum
	(Percent of taxable wages)		
Alabama.	0.50	1.12	2.70
Alaska	1.30	2.86	3.80
Arizona	0.20	1.37	2.90
Arkansas	0.30	1.48	4.20
California	1.00	3.31	4.10
Colorado	0.00	0.41	3.60
Connect icut	1.40	2.42	5.00
Delaware	1.40	2.60	4.30
District of Columbia	0.70	1.12	2.70
Florida	0.10	0.67	4.50
Georgia	0.08	0.98	3.36
Hawaii	1.30	1.85	3.00
Idaho	1.10	2.12	4.70
Illinois	0.10	2.20	4.00
Indiana	0.08	1.00	3.10
Iowa	0.00	1.09	4.00
Kansas	0.00	2.16	3.60
Kentucky	0.30	1.72	3.70
Louisiana	1.00	1.68	2.70
Maine	1.90	2.59	4.50
Maryland	0.10	1.52	3.80
Massachusetts	2.30	3.54	5.10
Michigan	0.70	2.99	6.60
Minnesota	0.90	1.62	5.00
Mississippi	0.80	1.08	2.70
Missouri	0.00	1.05	3.60
Montana	0.50	1.66	3.10
Nebraska	0.10	1.14	2.70
Nevada	2.70	2.70	2.70
New Hampshire	0.075	1.24	4.00
New Jersey	1.20	3.35	5.50
New Mexico	0.30	1.59	3.30
New York	1.30	2.78	5.00
North Carolina	0.20	0.92	4.70
North Dakota	0.90	2.42	4.20
Ohio	0.20	1.63	3.90
Oklahoma	0.40	1.44	2.70
Oregon	1.224	2.05	2.958
Pennsylvania	0.90	2.15	4.00
Puerto Rico	2.95	2.70	3.53
Rhode Island	2.20	3.02	4.00
South Carolina	0.25	1.30	4.10
South Dakota	0.00	0.89	2.70
Tennessee	0.30	1.54	4.00
Texas	0.10	0.63	4.00
Utah	1.40	1.75	2.70
Vermont	0.90	1.97	5.00
Virginia	0.05	0.42	2.70
Washington	3.00	3.00	3.00
West Virginia	0.00	1.40	3.93
Wisconsin	0.00	1.63	4.70
Wyoming	0.22	1.07	2.92

SOURCE: Hearings before the Subcommittee on Unemployment Compensation of the Committee on Ways and Means, House of Representatives, 94th Congress, 1st Session, April 8, 10, 14, 13, 21, 22, 30, and May 1, 1974, pp. 13-37.

Current Status

Budget Outlays

Total budget outlays for the unemployment compensation system have grown dramatically in recent years. In 1966 outlays were about $2.3 billion. For fiscal year 1975 they were about $14 billion. Outlays for fiscal year 1976 are estimated to be above $19 billion. This growth is depicted in Figure 4(a), along with other pertinent data which will be utilized later in this chapter.

Several factors have caused this dramatic growth in outlays:

- The unemployment rate has increased from an annual average rate of 3.8 percent in 1966 to 5.6 in 1974 and 8.5 in 1975. In the second quarter of 1975 it reached 8.9 percent.

- The duration of benefits has been increased through the Extended Benefits (EB) and Federal Supplemental Benefits (FSB) programs.

- Coverage has been extended to previously uncovered workers through the Special Unemployment Assistance (SUA) program.

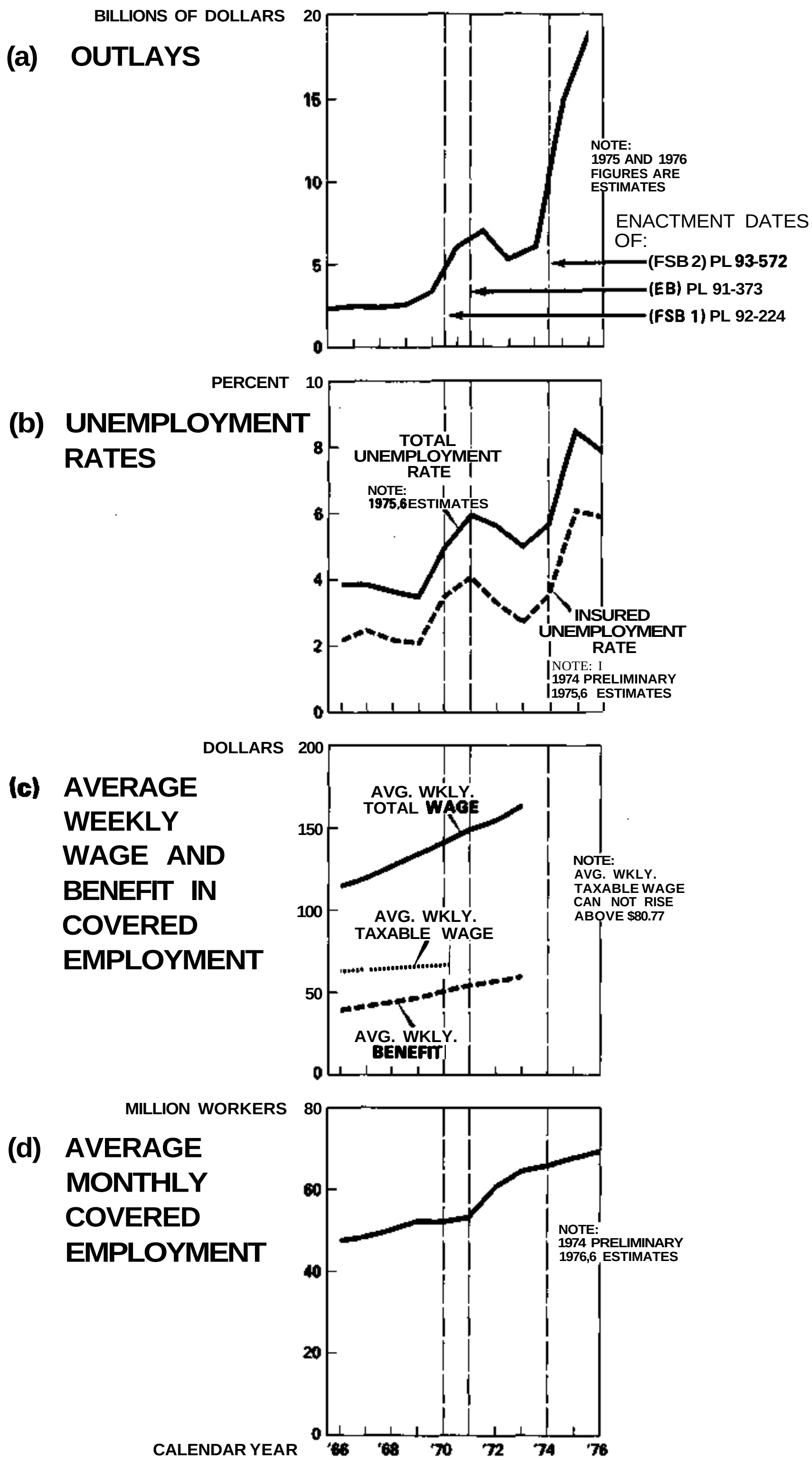
- Maximum and average weekly benefits have increased with increases in wages and salaries.

The increase in outlays has created two basic program financing problems. First, some state unemployment compensation trust funds have become insolvent. This has forced them to borrow from the federal government. Second, federal expenditures out of general revenues have increased for loans to the states and the federally supported programs (EB, FSB, and SUA). Table 2 depicts the relative changes in the source of outlays between fiscal year 1974 and fiscal year 1975. *It* shows that federal fund outlays have quadrupled, while state trust fund outlays have doubled.

State and Federal Trust Funds

Payroll taxes paid by employers for unemployment compensation are credited to two different sets of accounts. First, state tax payments are credited to each state's unemployment compensation trust fund account in the federal treasury. States withdraw from these accounts to pay regular unemployment benefits and the state share of extended benefits. Second, the employer's federal tax payments are credited to a set of federal accounts.

Figure 4
Trends in Selected Data Related to Unemployment Compensation



SOURCES:

(a) *Handbook of Unemployment Insurance Data* - U.S. Dept. of Labor, Employment and Training Administration, 1971.

(b) *Information on Unemployment and Unemployment Compensation Programs* - Committee on Ways and Means, U.S. House of Representatives, Sept., 1975.

(c) *Manpower Report of the President, 1975.*

(d) Unpublished Employment and Training Administration Data.

TABLE 2--BUDGET OUTLAYS FOR UNEMPLOYMENT COMPENSATION

Funds	Outlays ($ thousands) FY 1974	FY 1975
1. State Trust Funds a/	5,766,943	12,426,000
2. Federal Funds	353,381	1,533,000
	6,120,324	13,959,000

SOURCE: U.S. Department of Labor Employment and Training Administration.

a. State Trust Funds Minus Advances.

The three accounts that receive the employer's federal tax payment are:

1. Employment Security Administration Account (ESAA), which finances federal and state costs associated with administering the unemployment compensation program.

2. Extended Unemployment Compensation Account (EUCA), which pays for 50 percent of the benefits under the Extended Benefits (EB) program. By means of repayable advances from general federal funds, it also finances the Federal Supplemental Benefits (FSB) program.

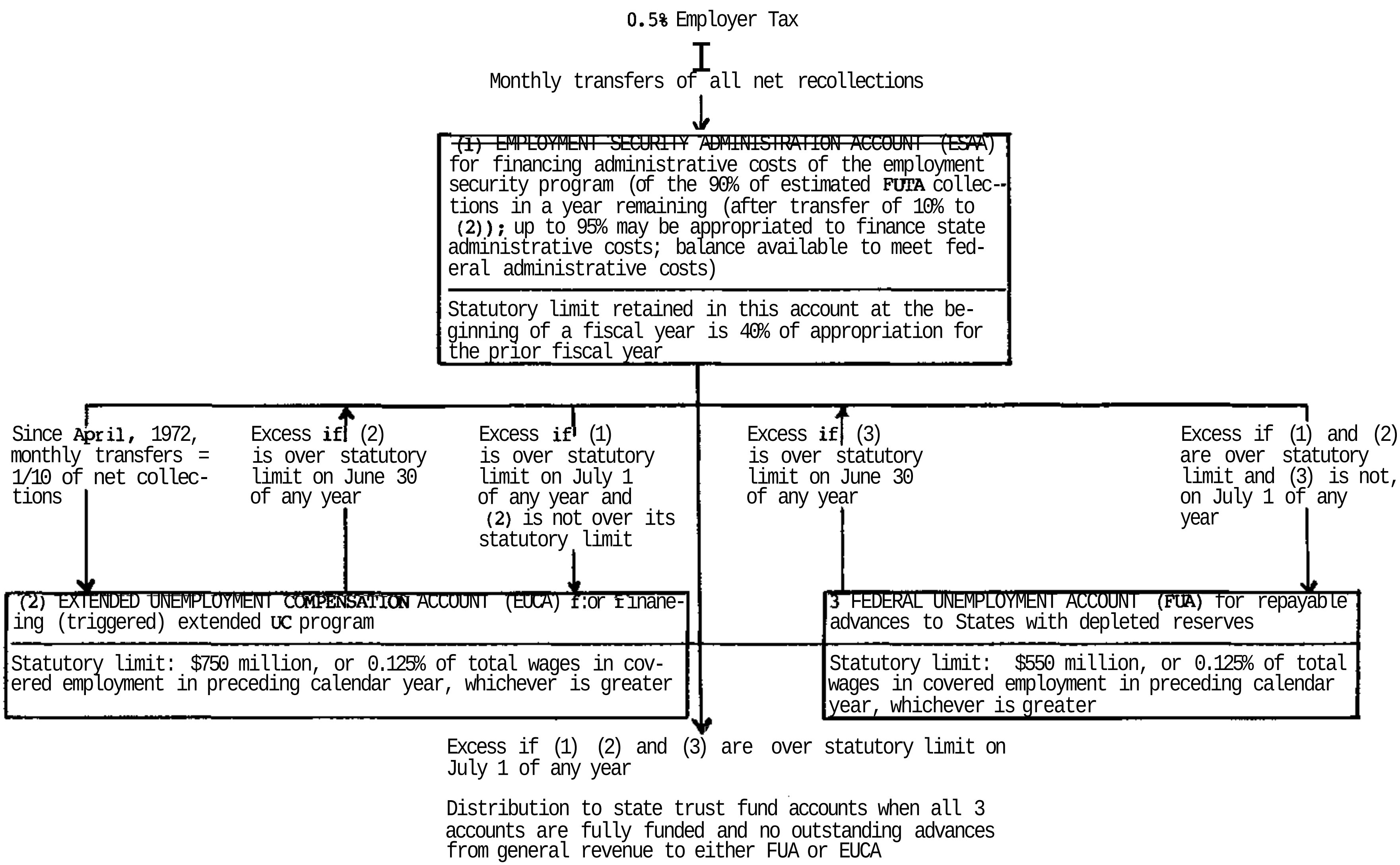
3. Federal Unemployment Account (FUA), which provides interest-free loans to states that cannot meet their benefit costs. If the loans are not repaid, the law requires that the federal tax on employers in the state be increased until they are repaid (unless the Secretary of Labor grants a waiver of this penalty increase).

The technical operation of these federal accounts is described in Figure 5.

77-207 0 - 76 - 4

FIGURE 5

FLOW OF FUTA FUNDS UNDER EXISTING FEDERAL STATUTES



SOURCE: U.S. Department of Labor, Employment and Training Administration.

Table 3 shows the balances in these three accounts from fiscal year 1970 through fiscal year 1975. The fiscal year 1975 figures indicate that the recession had significant effects on both EUCA (extended and emergency programs) and FUA (state loans).

As of January 1976, 16 states plus the District of Columbia and Puerto Rico have required advances from the federal accounts (which in turn have required advances from general federal revenues). These outstanding advances totaled approximately $2 billion. Table 4 provides exact breakdowns by state.

According to the report accompanying H.R. 10210 (a bill creating major changes in the unemployment compensation system), by the end of calendar year 1976 as many as 30 states will require loans. As more state programs become insolvent, it becomes increasingly apparent that the current level of financing is inadequate to meet demands created by extended high levels of unemployment.

State Reserve Ratios

Most states have linked changes in maximum weekly benefit amounts to changes in the average covered wage in the state. This means that as the average covered wage increases in a state, the maximum weekly benefit amount also increases. However, revenues to finance the system have not increased proportionately. Because the taxable wage base has increased much more slowly (from $3,000 in 1940 to $4,200 in 1974) than average wages, the percentage of total wages that are taxable has decreased from 93 percent to about 50 percent. Figure 4(c) illustrates this discrepancy.

The reserve ratio is a measure of the ability of a state's trust fund to remain solvent in the face of periods of high unemployment. For any state, the reserve ratio relates the current ratio of reserves to total covered wages to the highest such ratio over some recent period (for example, since 1958).

Table 5 presents reserve ratios for each state program. It shows that the ratio ranged from 0.02 in Washington to 3.01 in South Carolina, with a national ratio of 1.05. Nineteen programs had reserve ratios that were less than 1.0. These state programs may risk insolvency during periods of high unemployment.

TABLE 3--BALANCE OF FEDERAL ACCOUNTS
(In millions of dollars)

Fiscal Year	Account Balances (end-of-year) ESAA	EUCA	FUA
1970	64.5	—	575.1
1971	168.4	41.2	550.0
1972	258.4	2.6	510.7
1973	464.0	60.9	510.7
1974	705.2	276.2	528.9
1975	340.6	116.3	4.0

SOURCE: Information on Unemployment and Unemployment Compensation Programs, Subcommittee on Unemployment Compensation of the Committee on Ways and Means, U.S. House of Representatives, September 22, 1975.

TABLE 4--OUTSTANDING ADVANCES TO STATE TRUST FUNDS

	Advances (as of January 1976) ($ millions)
Alabama	18.0
Arkansas	8.0
Connecticut	276.2
Delaware	6.5
District of Columbia	12.6
Hawaii	2.0
Illinois	146.8
Maine	3.4
Massachusetts	180.0
Michigan	388.0
Minnesota	73.0
Nevada	3.0
New Jersey	404.3
Pennsylvania	234.2
Puerto Rico	44.0
Rhode Island	49.8
Vermont	30.4
Washington	107.6
Total Outstanding Advances	1,988.0

SOURCE: Branch of State Tax Accounting and Controls, Unemployment Insurance Service.

TABLE 5--STATE RESERVE RATE MULTIPLES

State	Multiple a/ (1973)
Alabama	1.02
Alaska	1.19
Arizona	2.71
Arkansas	1.15
California	1.01
Colorado	1.62
Connecticut	0.14
Delaware	1.43
District of Columbia	1.88
Florida	1.69
Georgia	2.64
Hawaii	0.71
Idaho	1.88
Illinois	0.75
Indiana	1.55
Iowa	2.28
Kansas	1.79
Kentucky	1.22
Louisiana	0.89
Maine	0.56
Maryland	0.76
Massachusetts	0.65
Michigan	0.57
Minnesota	0.61
Mississippi	1.65
Missouri	1.66
Montana	0.72
Nebraska	2.22
Nevada	0.66
New Hampshire	1.92
New Jersey	0.29
New Mexico	1.60
New York	1.17
North Carolina	2.44
North Dakota	1.27
Ohio	1.05
Oklahoma	0.90
Oregon	0.86
Pennsylvania	0.64
Puerto Rico	0.40
Rhode Island	0.53
South Carolina	3.01
South Dakota	2.75
Tennessee	1.58
Texas	1.34
Utah	1.85
Vermont	0.16
Virginia	2.63
Washington	0.02
West Virginia	1.20
Wisconsin	1.55
Wyoming	1.55
United States	1.05

SOURCE: Hearings before the Subcommittee on Unemployment Compensation of the Committee on Ways and Means, House of Representatives, 94th Congress, 1st Session, April 8, 10, 14, 13, 21, 22, 30, and May 1, 1974, pp. 13-37.

a. Reserve rate as a multiple of highest 12-month benefit cost rate since January 1, 1958

$4,200 is already half of the average annual wage $8,400.) However, this analysis was based on the assumption that the employer bears the burden of the payroll tax. The extent to which employers shift the burden of the tax to their employees or to consumers limits the validity of this conclusion.

If the tax is shifted to employees, their take-home wages would be lowered. Estimates of the extent of shifting of the payroll tax have not been adequately developed for policy purposes. However, these estimates have been developed for the payroll tax for social security, with the conclusion that the burden of the employer's tax contribution is shifted to the employee. 4/ The same conclusion might be inferred for the payroll tax for unemployment compensation, but the analogy is not clearcut. This is because the distribution of unemployment compensation benefits among employees is even more uneven than the distribution of social security benefits.

A final possible treatment of the taxable wage base is to allow it to adjust automatically to changes in the wage level. This would provide strong protection against the development of a long-run imbalance between revenues and payments. However, such indexing proposals have not received a great deal of support in the recent past.

Increasing Tax Rates

Increasing the payroll tax rate will also increase tax revenue. As was the case with increasing the taxable wage base, increasing the payroll tax would increase the financial cost to employers and employees depending upon the extent to which the tax is shifted.

Increasing the federal tax rate above its present 3.2 percent will increase the rate at which funds flow into ESAA, EUCA, and FUA. An increase in the federal tax rate would reduce the need for general revenue advances to EUCA and FUA to pay for extended benefits and loans to states.

There are some disadvantages to increasing the federal tax rate. First, it would affect employers in all states. Consequently employers in states with low unemployment rates would probably pay for some of the extended benefits in states with high unemployment rates and there would be a period in which contributions from solvent states would support loans to insolvent states. Second, it would affect all employee turnover.

---

4. John A. Brittain, The Payroll Tax for Social Security, (Washington, D.C.: Brookings Institution, 1972).

Analysis of Alternatives

The basic problem in financing the unemployment compensation system is the construction of a financing method which will match benefit costs over long periods of time. An additional problem is the necessity to accumulate adequate reserves to provide funds for temporary situations in which benefit costs exceed trust fund revenues.

Solutions to the latter problem have been proposed in the form of setting minimum reserve ratios for state trust funds of 1.0 or 1.5. A ratio of 1.0 would require payroll tax increases in 18 states, a ratio of 1.5 would require such increases in 30 states. However, these would be offset by a decreased need for general federal revenue advances to the FUA account.

While the reserve ratio requirements deserve further study, they might present great financing difficulties for those states which currently have very low ratios. These requirements also require much more detailed specifications regarding the circumstances under which a state may be allowed to use its reserves, and when the state is required to replenish them.

Solutions to the long-run financing problems involve some combination of the following measures: (1) increasing the taxable wage base; and (2) increasing the tax rate. These changes would have different effects.

Increasing The Taxable Wage Base

Proposals have been made to increase the taxable wage base from its present $4,200 to $6,000 or even to $14,000. Increasing the taxable wage base would increase revenues, because the tax rate would be applied to a larger payroll. However, it is unclear whether employers or employees (or possibly even consumers) would bear the burden of the increase.

If the employer bears the burden, raising the taxable wage base would significantly increase his financial costs. Secondly, as the taxable wage base approaches total payroll, the employer's incentive to maintain stable employment is reduced. This conclusion is based upon a recent theoretical analysis which concludes that in order to encourage stable employment the taxable wage base should be set between 50 and 100 percent of average annual earnings. 5/ (The current taxable wage base of

---

5. Frank Brechling, "The Incentive Effects of the U.S. Unemployment Insurance Tax: A Summary of Results" (Washington: Public Research Institute, 1975), (mimeo), p. 28.

Increases in state tax rates can be accomplished by changes in state law requirements contained in FUTA. For example, the federal government could raise the lowest minimum and/or maximum tax rates permitted. It could also change the bases for the tax schedule by altering the experience rating systems of each state program.

Changes in the minimum and maximum state tax rates can have a direct effect not only on solvency but also on employment. For example, increasing the minimum tax rate will raise revenue from employers with good experience ratings. This decreases the incentive for stable employment. Alternatively, increasing the required maximum state tax rate will penalize firms with poor experience ratings. This would increase the incentive for stable employment, but in a recession would further hurt employers already suffering severe economic problems.

Table 6 summarizes the effects these policy alternatives would have.

TABLE 6--SUMMARY OF FINANCING ALTERNATIVES

Potential Changes	No. of States (territories) Affected	Fund Receiving Revenues	Other Comments
Increase taxable wage base.	52	Both state trust funds and federal FUTA accounts.	Vfould correct current imbalance of revenues and benefit payments.
Provide automatic cost-of-living adjustment of taxable wage base.	52	Both state trust funds and federal FUTA accounts.	Vfould provide long-term balance between revenues and benefit payments.
Increase effective federal tax rate above 0.5 percent.	52	Federal FOTA accounts.	Vfould correct current imbalance of revenue and benefit payments.
Increase required minimum state tax to 1.0 percent.	35	Specific state trust funds.	Vfould increase revenues in specific states, some of whose funds may be currently sound. Vfould affect firms with high turnover.
Increase required maximum state tax rate to 3.0 percent.	13	Specific state trust funds.	Vfould increase revenues in specific states, some of whose funds may be currently sound. Vfould affect firms with high turnover.
Establish a required reserve of 1.0 percent.	18	Specific state trust funds.	Vfould only affect those state funds which are in possible danger of running a deficit. Vfould only provide solution to problem of short-run fluctuations in revenues and benefit payments.
Establish a required reserve of 1.5 percent	30	Specific state trust funds.	Vfould affect most states. Vfould only provide solution to problem of short-run fluctuation in revenues and benefit payments.

CHAPTER III

EXTENSION OF COVERAGE

Background

Most wage and salary workers face the risk of loss of employment and the attendant loss of income. Coverage has tended to expand as the unemployment compensation system has evolved. Today, universal coverage has almost been achieved. 6/ Still, some categories of workers have been excluded from permanent unemployment compensation coverage, primarily because of possible difficulties connected with administering the program for them or the anticipation of high costs.

Current Status

There are approximately 84 million wage and salary workers in the United States. About 15 percent or 11.9 million are not covered by the federal unemployment compensation system. About 90 percent or 11 million of these uncovered workers are in the following occupations:

- state and local government (8.3 million workers);
- domestic service (1.5 million workers); and
- agriculture (1.2 million workers).

The remaining 0.9 million workers are in small nonprofit organizations and other small firms. The characteristics of these uncovered workers and their unemployment levels are shown in Table 7.

---

6. Approximately 5-1/2 million workers (including servicemen) are covered by three special programs: Railroad Unemployment Insurance, Unemployment Compensation for Federal Civilian Employees (UCFE), and Unemployment Compensation for Ex-Servicemen (UCX). The latter two programs (UCFEX) are administered as part of the regular unemployment insurance system, with full reimbursement to the states out of general federal revenues. The railroad program is administered and financed by the Railroad Retirement Board.

TABLE 7—CHARACTERISTICS OF WORKERS IN INDUSTRIES NOT COVERED BY PERMANENT UNEMPLOYMENT COMPENSATION SYSTEM

	Average Number Of Employed 1974 (thousands)	Average Number Unemployed 1974 (thousands)	Unemploy-ment Rate	Mean Earnings All Workers 1973
Private Household Workers	1,228	56	4.4	$ 885
Farm Laborers & Supervisory	1,405	75	5.1	$2,130
State and Local Government Employees	11,561	NA	NA	$7,495
Entire Labor Force	85,936	5,076	5.6	$7,173

SOURCE: (1) Bureau of Labor Statistics, "Employment And Unemployment In 1974," Special Labor Force Report 178, 1975.

(2) Bureau of the Census, "Consumer Income," Series P-60, No. 97 (January 1975).

NA - Not Available.

28

Although these workers are not covered by the permanent federal unemployment compensation system, states can individually decide to extend coverage to them. Twenty-six states cover some portion of state government workers. However, only six states cover workers in local governments; four states cover domestic workers; and four states cover agricultural workers.

The number of unemployed eligible to receive benefits is further reduced by factors other than industry coverage. New entrants and reentrants to the labor force and workers fired for a variety of disqualifying acts are not eligible for support. Voluntary job leavers are only eligible for benefits in about half the states, and then only after a waiting period usually longer than a month. Of the remaining "involuntarily unemployed," only workers with sufficient work experience in covered industries may receive benefits. The evidence presented in Table 8 suggests that approximately 60 percent of the unemployed in September 1975 could be eligible for benefits.

TABLE 8--UNEMPLOYMENT BY REASON
(September 1975)

Reason	Number of Unemployed (thousands)	Percent of Unemployed
Job losers	4,576	57.2
Job leavers	814	10.2
Reentrants to labor force	1,786	22.3
New entrants	819	10.2

SOURCE: Bureau of Labor Statistics, Employment and Earnings, September 1975.

The Temporary Program to Expand Coverage

In December 1974, the Congress enacted the Emergency Jobs and Unemployment Assistance Act. Title II of the Act established a temporary program, entitled Special Unemployment Assistance (SUA). SUA expanded coverage to the 11.9 million workers not covered by the permanent system. The program is scheduled to expire at the end of 1977, with claims being entirely phased out on March 31, 1978, although legislation is currently pending which would extend the program one more year.

It is too early to evaluate fully the results of this emergency program. Outlays under the program are estimated to be roughly $900 million for fiscal year 1976.

Analysis of Alternatives

Legislation was recently signed into law that will extend coverage to all the excluded groups described above in 1978. However, this does not imply that all workers will be covered. For example, the definition of covered domestic workers used in the law will still exclude from coverage approximately 75 percent of domestic workers. Similarly, the provision to extend coverage to agricultural workers will exclude more than 40 percent of these workers. 7/

Two basic issues surrounded these extensions of coverage. One was the effects of seasonal unemployment on benefit costs for agricultural workers. Some have argued that each group of workers should in effect be able to finance its own benefits and that agricultural workers, with fairly high and consistent levels of seasonal unemployment, would not be able to do so. However, the evidence indicates that there already are covered industries from which workers draw more benefits than they contribute in revenues (under the current experience rating system). The benefit-tax ratio is the ratio of unemployment compensation benefits received by individuals previously employed in an industry to the total payroll taxes paid by firms in that industry. Table 9 shows that the agriculture and construction industries have benefit-tax ratios greater than one, and that benefits to former employees in these industries are in effect subsidized by payroll taxes in the transport and finance groups (and, to a smaller extent, trade and services).

The second issue was whether extension of coverage to domestic workers in private homes will involve any significant administrative difficulties. The only information available on this issue is that under the current unemployment compensation system it is apparently feasible for firms with only one employee to cover that employee.

---

7. Derived from Staff Data and Materials on Unemployment Compensation Amendments of 1976 (H.R. 10210), Committee on Finance, U.S. Senate, September 3, 1976.

TABLE 9--BENEFIT-TAX RATIOS BY INDUSTRY

Industry	California Only a/	Ten Selected States b/
Agriculture, forestry, and fisheries	2.13	2.44
Mining and quarrying	0.84	1.34
Construction	1.73	1.67
Manufacturing	1.11	1.08
Transport, communications, and utilities	0.71	0.69
Wholesale and retail trade	0.81	0.77
Finance, insurance, and real estate	0.54	0.51
Services	0.89	0.80

SOURCE: John H. Pencavel, "Some Labor Market Implications of the Payroll Tax For Unemployment and Old Age Insurance," Technical Analysis Paper No. 16, Department of Labor (January 1974).

a. Based on annual observations for the years 1962-71.

b. Based on annual observations for ten states for the years 1957-67.

When coverage of SUA recipients is shifted to the regular permanent unemployment insurance system, their benefit costs will be shifted from all federal taxpayers to covered employers and employees in each state.

CHAPTER IV

THE BENEFIT PAYMENT

Background

The amount of the benefit payment is an important feature of the unemployment compensation system. The Social Security Act of 1935 delegated to each state the authority to set whatever benefit standards it wished. Consequently, for the past forty years the benefit amount has varied widely among states.

Attempts have been made to set federal benefit standards since the system was started. While attempts to legislate benefit standards have not met with success, goals have been suggested on a number of occasions. For example, the Eisenhower Administration and successive administrations have stated the national goal as a certain minimum proportion of eligible workers' wages. In 1954, President Eisenhower recommended that the states raise the benefit maxima so that the payments to roost beneficiaries would equal at least half their regular earnings. 8/ The goal has undergone various changes by successive administrations. In 1973 President Nixon stated the goal as follows: ". . . to provide at least four-fifths of the Nation's insured work force half pay or better when unemployed." 9/

The benefit amounts are determined by formulas that vary widely among the states. Most states use the most recent calendar quarter to determine a worker's average gross weekly wage, then pay him approximately half that amount, up to a state determined maximum. Alternatively, some states average all weekly wages in the past year instead of one quarter and then pay approximately one-half of this amount, again up to a maximum.

The maximum state benefit level is determined in two ways. Thirty-two states set the maximum as a fixed percent of the average weekly wage in covered unemployment in the state. This provides automatic adjustment of the maximum as the wage level increases. The other states set their maximum benefit levels at a fixed dollar amount. Unless statutory action is taken in these states, actual weekly benefits will lag behind average weekly wages.

Figure 6 illustrates how the maximum weekly benefit amounts relate to the average gross weekly wages of covered employees among the states. It indicates that forty-five state programs have maximum weekly benefit amounts of at least 50 percent of average gross weekly wages.

---

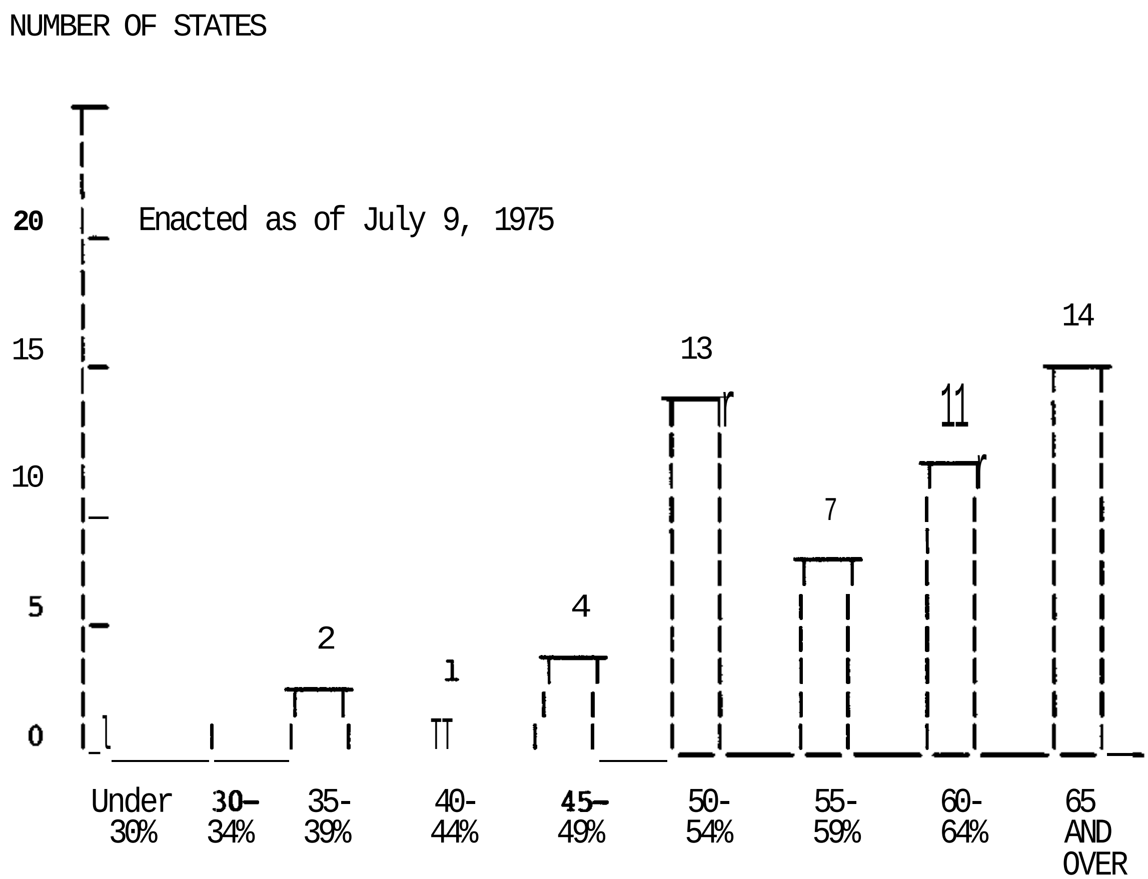
8. Economic Report of the President, January 1954.

9. Richard Nixon, Message to Congress, (April 12, 1973).

77-207 O - 76 - 5

FIGURE 6

MAXIMUM UNEMPLOYMENT COMPENSATION BENEFIT LEVELS
AS A PERCENT OF AVERAGE WEEKLY WAGES
(1975)



Maximum Benefit Levels as a Percent of Average Gross Weekly Wages in Covered Employment.

SOURCE: U.S. Department of Labor, Manpower Administration, Unemployment Insurance Service, July 9, 1975.

Current Status

Benefit Levels

The level of recipient benefits is usually discussed in relation to the previous wage level. The ratio of these two numbers is called the wage replacement rate. The gross replacement rate is the ratio of benefits to the individual's previous gross wages. This is the replacement rate used in the presidential goal described above.

Data on replacement rates is not issued by the Unemployment Insurance Service. However, actual replacement rates were calculated for a sample of those who had exhausted regular benefits in a study by Mathematica, Inc. 10/ Table 10 presents the gross replacement rates for this sample. These rates approximately center around the 50 percent level often espoused in the literature.

TABLE 10--GROSS WAGE REPLACEMENT RATES
FOR MATHEMATICA EXHAUSTEE SAMPLE

Replacement Rate	Percent of Sample: White	Percent of Sample: Nonwhites
0 - 20%	6.7	4.5
20 - 40	32.6	36.1
40 - 50	27.5	29.4
50 - 60	21.5	19.1
60 - 80	9.5	8.6
80 +	2.4	2.3
	100%	100%
Mean replacement rate	44	44
Median replacement rate	44	43

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Report No. 76-01, pp. 74-75.

---

10. A Longitudinal Study of Unemployment Insurance Exhaustees, by Walter Nicholson and Walter Corson, Mathematic Policy Research Project Report No. 76-01.

It should *be* noted that the replacement rates from the exhaustee study were obtained from a sample of unemployment compensation recipients in only four cities and therefore may not be representative of the nation as a whole. Also, because the sample consists solely of exhaustees of regular benefits, the replacement rates may be higher than the rates for all recipients. 11/

Some analysts contend that the gross replacement rate is not an accurate measure of the adequacy of benefit levels. Unemployment compensation benefits, which are not taxable, should be calculated as a proportion of a worker's previous after-tax pay, yielding a net replacement rate. In addition, work-related expenses and fringe benefits should also be taken into account.

The Mathematica study also provides net replacement rates that take into account income and payroll taxes and work-related expenses. These are displayed in detail in Tables 11 and 12. The net replacement rates are higher than the gross replacement rates, although approximately 60 percent of the sample still had net replacement rates of 60 percent or lower. The main factors that influence these net wage replacement rates are the presence of a working spouse and/or young children.

Distribution of Benefits and Costs

Table 13 presents the distribution of unemployment compensation benefits by family income. Families with incomes of over $10,000 a year received 52 percent of total benefits in 1970. It is therefore clear that the unemployment compensation system is not directed exclusively at low-income families.

However, it should be remembered that many persons consider the system to be an insurance system, at least in part. Discussion of insurance aspects requires consideration of the distribution of costs as well as benefits. This research has been performed under the assumption that the payroll tax is fully shifted to employees. 12/

---

11. *Ibid.*, p. 70.

12. Gary Fields, The Direct Labor Market Effects of the U.S. *Unemployment Insurance System; A Review of Recent Evidence*, Technical Analysis Paper, No. 26, Office of the Assistant Secretary for Policy Evaluation and Research, U.S. Department of Labor (January 1975), Table 8.

TABLE 11--DISTRIBUTION OF EXHAUSTEE HOUSEHOLDS BY FAMILY TYPE
AND PERCENTAGE OF WAGES (NET OF TAXES AND WORK RELATED
EXPENSES) REPLACED BY UI BENEFITS

Whites

Percentage of Wage Replaced by UI Benefits	Hale Exhaustee Wife Present: Child Under 16	Hale Exhaustee Wife Present: No Child Under 16	Female Exhaustee Husband Present: Child Under 16	Female Exhaustee Husband Present: No Child Under 16	Male Exhaustee No Wife Present: Child Under 16	Male Exhaustee No Wife Present: No Child Under 16	Female Exhaustee No Husband Present: Child Under 16	Female Exhaustee No Husband Present: No Child Under 16	Male Non-Head	Female Non-Head	Total Sample
Total: Number in Sample	89	180	125	187	8	177	31	171	47	52	1067
Percent	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
0 - 20%	5.6	12.8	4.0	3.7	0.0	5.1	0.0	2.9	4.3	1.9	5.3
20 - 40	34.8	32.2	4.0	11.2	12.5	28.3	16.1	11.7	19.2	11.5	19.3
40 - 50	20.2	21.7	8.8	11.2	12.5	22.0	19.4	12.3	23.4	13.5	16.3
50 - 60	12.4	18.3	11.2	18.2	25.0	19.2	22.6	26.3	17.0	25.0	18.8
60 - 80	19.1	11.7	33.6	43.3	37.5	21.5	19.4	35.1	23.4	34.6	27.8
80 +	7.9	3.3	38.4	12.3	12.5	4.0	22.6	11.7	12.8	13.5	12.4

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Project Report No. 76-01, p. 78.

TABLE 12--DISTRIBUTION OF EXHAUSTEE HOUSEHOLDS BY FAMILY TYPE AND PERCENTAGE OF WAGES (NET OF TAXES AND WORK RELATED EXPENSES) REPLACED BY UI BENEFITS

Nonwhites

Percentage of Wage Replaced by UI Benefits	Male Exhaustee Wife Present		Female Exhaustee Husband Present		Male Exhaustee No Wife Present		Female Exhaustee No Husband Present		Male Non-Head	Female Non-Head	Total Sample
	Child Under 16	No Child Under 16	Child Under 16	No Child Under 16	Child Under 16	No Child Under 16	Child Under 16	No Child Under 16			
Total: Number in Sample	112	66	71	44	15	117	31	171	47	52	1067
Percent	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
0 - 20%	1.8	3.0	0.0	2.3	0.0	3.4	0.0	1.6	5.5	2.0	2.2
20 - 40	27.7	19.7	7.0	9.1	33.3	20.5	6.3	14.8	16.4	11.8	16.6
40 - 50	30.4	16.7	12.7	11.4	26.7	24.0	16.5	16.4	23.3	15.7	20.2
50 - 60	17.9	34.9	11.3	25.0	26.7	21.4	19.0	21.3	27.4	9.8	20.9
60 - 80	17.9	19.7	46.5	36.4	6.7	22.2	36.7	39.3	20.6	29.4	27.9
80 +	4.5	6.1	22.5	15.9	6.7	8.6	21.5	6.6	6.9	31.4	12.3

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Project Report No. 76-01, p. 79.

TABLE 13--THE DISTRIBUTION OF UNEMPLOYMENT COMPENSATION BENEFITS BY INCOME CLASS (1970)

Income Class	Percent of UC Benefits
0 - 4,999	17
5,000 - 9,999	31
10,000 - 14,999	24
15,000 - 24,999	20
25,000+	8

SOURCE: Martin Feldstein, "Unemployment Compensation: Adverse Incentives and Distributional Anomalies," National Tax Journal, XXVII, No. 2, June 1974, p. 238.

If the tax is shifted to employees exactly according to the amount of tax they cause the employer to incur, then the benefits by income class are approximately equal to payroll tax contributions by income class. However, if the total payroll tax is distributed among employees according to their proportional shares of the total wage bill, then lower income groups pay in contributions proportionally less than they receive in benefits. Therefore, under this second assumption, the unemployment compensation system as a whole contains some redistributive welfare aspects.

As a final note on distribution, a perverse effect of the system on certain low-income workers should be noted. Workers employed by covered employers will probably bear some portion of the payroll tax. However, if the employee receives low enough wages or has an erratic work history, he may be ineligible for unemployment compensation benefits. Thus, for these few workers the system will clearly have a negative effect.

Work Incentives

As with any program which provides income to individuals, the work incentive effects must be analyzed. This analysis is hindered in the case of unemployment compensation by difficulties in obtaining the necessary data for a national sample. Therefore, any estimate of work disincentive effects must be used cautiously.

One well-executed study estimates that the regular 26-week unemployment compensation program increases the unemployment rate by from 0.2 to 0.35 percentage points. 13/ Other studies have estimated the disincentive effects to be as high as 0.9 percentage points.

Two comments should be made about these estimates. First, they were calculated using periods of relatively low unemployment. In the current period of high unemployment suitable work is more difficult to find, and therefore the disincentive effects of the unemployment compensation system may be less than the estimates.

Secondly, it should be emphasized that the disincentive effect described above can be labeled neither high nor low. It is merely one cost of a system which provides benefits, and acceptance or rejection of the entire package is a societal decision.

Analysis of Alternatives

Two major policy options which relate to the benefit payment are the establishment of federal minimum standards for benefit levels and the taxation of unemployment compensation benefits.

Proposals for federal benefit standards usually include a statement of a minimum gross replacement rate, up to a dollar maximum at least as great as a given percentage of each state's average weekly wage. 14/

---

13. Stephen T. Marsten, "The Impact of Unemployment Insurance on Job Search," Brookings Papers on Economic Activity (1975:1), pp. 13-60.

14. An example would be a standard requiring states to provide a weekly benefit amount of at least 50 percent of each claimants average weekly wage, up to a maximum of at least 66-2/3 percent of each state's average weekly wage. Such a standard would affect payments to at least some individuals in all states.

As described in an earlier section, the gross replacement rate is often not an accurate measure of the change in a worker's disposable income (which is better reflected by the net replacement rate). However, standards phrased in terms of gross replacement rates are much easier to administer, and would not require significant changes in the state unemployment compensation agencies.

Table 14 shows the effects of raising all benefit maxima to two-thirds of each state's average weekly wage. (As these data are once again taken from the Mathematica exhaustee study, the caveats described on page 30 should be reiterated.) The major effect of a standard for maximums is to raise the replacement rates of those initially below 40 percent (compare Tables 10 and 14).

Taxation of unemployment compensation benefits is sometimes advocated as a means to equalize net replacement rates and decrease the worst work disincentive effects. (Like all other income security payments, unemployment compensation is currently untaxed.) As Tables 15, 11, and 12 indicate, the highest replacement rates would indeed be most affected by taxation of unemployment compensation benefits.

TABLE 14--DISTRIBUTION OF EXHAUSTEE HOUSEHOLDS BY PERCENTAGE OF GROSS WAGE REPLACED BY UI BENEFITS WHEN BENEFIT MAXIMA ARE TWO-THIRDS STATE AVERAGE WEEKLY WAGE

Percentage of Wage Replaced by UI Benefits	Whites	Nonwhites
Percent	100.0%	100.0%
0 - 20%	4.0	2.8
20 - 40	20.2	22.4
40 - 50	35.9	37.9
50 - 60	25.6	22.4
60 - 80	11.6	11.0
80 +	2.7	3.6

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Project Report No. 76-01, pp. 82-83.

However, at the same time the average payment level would be decreased. If this side effect is unintended, then taxation of unemployment compensation benefits would have to be accompanied by a general increase in the (gross) benefit determination rules currently in use by the states. One possible result of this combination could be an unchanged average net replacement rate accompanied by a smaller variation in these rates.

TABLE 15--DISTRIBUTION OF EXHAUSTEE HOUSEHOLDS
PERCENTAGE OF WAGE (NET OF TAXES) REPLACED BY
UI BENEFITS WHEN BENEFITS ARE TAXED

Percentage of Wage Replaced by UI Benefits	White Total Sample	Nonwhites Total Sample
Percent	100.0%	100.0%
0 - 20%	5.7	2.9
20 - 40	24.9	25.1
40 - 50	21.7	24.5
50 - 60	24.3	26.2
60 - 80	19.3	16.2
80 +	4.1	5.1
Mean Percent	49	50
Median Percent	49	49

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Project Report No. 76-01, pp. 80-81.

CHAPTER V

DURATION OF BENEFITS

Background

Duration of benefits has been a controversial issue throughout the history of the unemployment compensation program. Since the program was designed essentially to assist workers during periods of "temporary" involuntary unemployment, policymakers have had difficulty determining what an appropriate duration should be. A duration which is adequate during a period of low unemployment may be inadequate during a recession.

The duration of benefits is established by state laws according to two basic methods:

1. Forty-two states and the District of Columbia use a "variable duration" approach based on the length of time a worker has spent in the labor force--the longer the period of work, the longer the duration of benefits.

2. Eight states and Puerto Rico use a "uniform duration" approach. All claimants who meet the state's qualifications are entitled to the same duration. Most states require a one-week waiting period before benefits begin.

Current Status

As described in the introduction, the federal-state unemployment compensation relationship contains the following four tiers of benefits:

- Regular benefits paid under state unemployment compensation laws;

- Federal-State Extended Benefits (EB)--part of permanent law; a temporary program triggered by high unemployment rates;

- Temporary Federal Supplemental Benefits (FSB)--temporary program financed by repayable advances from general federal revenues; and

- Special Unemployment Assistance (SUA) benefits--temporary program financed by general federal revenues.

As Figure 7 shows, an individual may be eligible to receive as much as 65 weeks of benefits from all tiers combined. However, many of jobless workers do not qualify for the maximum duration of benefits because of an insufficient work history.

Although the maximum duration of regular benefits is 26 weeks in 42 states, only six of those states provide all eligible claimants with 26 weeks. In the remaining 36 states, potential duration for a substantial portion of beneficiaries is less than 15 weeks. Moreover, only nine states have regular durations exceeding 26 weeks.

One dimension of the adequacy of benefit duration is the number of recipients who exhaust their benefits. During periods of relatively low unemployment, approximately 20 percent of beneficiaries exhaust benefits. However, this figure increased to 31 percent in 1974 as a result of the onset of the recent recession before the triggered temporary programs lowered the rate again.

Analysis of Alternatives

The primary issue involved in determining duration of benefits is the role of the unemployment compensation system. If the system is designed to provide benefits during short-term involuntary unemployment, then a shorter duration is justified than would be the case if the system is considered to be at least partially an income assistance system for the unemployed.

The same issue applies to the extended benefits program and the temporary supplemental programs. They can be considered to be a recognition of the fact that the duration of involuntary unemployment increases in times of high unemployment, or a special temporary income assistance program aimed at a specific group--i.e., the previously employed.

Table 16 presents the costs and caseloads of the various extended duration programs. These obviously represent the cost savings and the number of unemployed who would be denied benefits if the programs had not existed in 1975. The programs depicted in Table 16 are the primary claimants of general federal funds in the unemployment compensation system. Therefore, if all these programs were eliminated, the need for federal funds in the system would also be eliminated (except in times of prolonged high unemployment).

FIGURE 7

PRESENT LAW - 1976

DURATION OF BENEFITS UNDER PERMANENT AND TEMPORARY UNEMPLOYMENT BENEFIT PROGRAMS

MAXIMUM DURATION REGULAR BENEFITS a/	FEDERAL-STATE EB b/	FSB - Jan. 1975 Mar. 1977 c/
STATE FUNDS	SHARED 50-50, FED.-ST.	100% FEDERAL
WEEKS 26		65

SPECIAL UNEMPLOYMENT ASSISTANCE d/

100% FEDERAL GENERAL REVENUE
WEEKS 39

SOURCE: Department of Labor, Manpower Administration, September 1975.

a. Regular benefits (state unemployment insurance laws): In 42 states, the maximum regular duration is 26 weeks, but only 6 of these states provide all eligible claimants with 26 weeks; in the other 36 States, potential duration for a significant proportion of beneficiaries is less than 15 weeks. Puerto Rico has uniform duration of 20 weeks. Nine states, one of which provides all eligible claimants with 30 weeks, have regular durations exceeding 26 weeks.

b. Federal State Extended Benefits (EB) (Federal-State Extended Unenployment Compensation Act of 1970): Permanent program, triggered into operation by high state or national insured unemployment rates. Maximum duration is 13 weeks, or 39 total of regular and EB; individual gets half his regular duration. In the 9 states with a regular maximum longer than 26 weeks, the weeks in excess of 26 paid during an extended benefit period are financed on a 50-50 basis.

c. Federal Supplemental Benefits (FSB) (Emergency Unenployment Compensation Act of 1974, as amended and extended by sec. 701. Tax Reduction Act of 1975, and the Emergency Compensation and Special Unemployment Assistance Act of 1975): Temporary 2-year program, triggered by same insured unemployment rates as Federal State EB. Individual duration equal to regular duration, not exceeding 26 weeks. Not available after March 31, 1977. Subject to triggering off beginning January 1, 1976, by reason of lower insured unemployment rate in the state.

d. Special Unemployment Assistance (SUA) (Title II, Emergency Jobs and Unemployment Assistance Act of 1974 as amended and extended by the Emergency Compensation and Special Unemployment Assistance Act of 1975): Temporary program of federal benefits for workers not eligible for regular state benefits. Benefit amount based on applying state benefit formula to individual's employment, disregarding difference between covered and noncovered work. Maximum duration 39 weeks.

TABLE 16--COSTS AND CASELOADS FOR UNEMPLOYMENT COMPENSATION PROGRAMS, CALENDAR 1975

	Benefit Payments ($ Billions)	Total Benefi- ciaries (Millions)	Average Weekly Insured Unemployment (Millions)
Regular Unemployment Compensation	12.1	12.2	4.1
Extended Benefits	2.8	4.3	0.8
Federal Supplemental Benefits	1.5	2.1	0.4
Special Unemployment Assistance	0.7	1.2	0.25

SOURCE: Department of Labor, Unemployment Insurance Service.

It should be noted that any extension of benefit duration may have a work disincentive effect. One study estimates that an increase in duration from 26 weeks to 65 weeks will increase the unemployment rate by 0.24 percentage points. 15/ However, this estimate was not calculated for a period of high unemployment and therefore may be too high.

Another potential area for policy analysis is the construction of the trigger mechanisms for the state extended benefits programs. Currently, these programs use state triggers that are a function of the number of persons in the state already receiving benefits. However, eligibility for and duration of regular benefits vary from state to state, so different states in the same economic condition can have different numbers of recipients of regular benefits. The result could be that one state triggers on an extended benefit program while the other does not. Because the extended benefit programs are funded by the federal FUTA tax, questions may arise concerning equity between the states.

---

15. Stephen T. Marsten, "The Impact of Unemployment Insurance on Job Search," Brookings Papers on Economic Activity, 1975: 1, pp 13-60.

Finally, the trigger mechanism does not take into account the numbers of unemployment compensation exhaustees, nor does it consider the possibility of high levels of unemployment in local labor markets located in states whose overall unemployment rates are lower. Proposals suggested to deal with these considerations are the inclusion of some portion of the exhaustees in the insured unemployment rate, and creation of local labor market triggers (such as those currently used in the SUA program).

CHAPTER VI

ADMINISTRATION

An Area Requiring Further Study

As is the case with other dimensions of the unemployment compensation system, administration of the system involves both the federal and state governments. The federal administrative responsibilities rest with the Unemployment Insurance Service (UIS), a division of the Employment and Training Administration of the U.S. Department of Labor. The UIS:

- determines the compliance of state laws and administration with federal law and regulations;
- collects data on both unemployment compensation and employment;
- reviews and approves state administrative budgets; and
- makes grants to the states for administering the programs from the federal trust fund.

Each state has its own bureau of employment security (which includes the unemployment insurance service and the employment service), and its own procedures for administering the program. States administer their unemployment compensation programs with a portion of the Federal Unemployment Tax Act (FUTA) collections redistributed to them by the federal government. The administrative responsibilities of the states include collecting wage data from employers; processing claims and appeals; issuing checks; enforcing the "work test," which requires that a recipient be available for suitable work; and providing employment services.

The states are also responsible for administering two special federal unemployment compensation programs: one for federal civilian employees, the other for ex-servicemen. Each state administers these programs according to its own laws and program rules, and is reimbursed from general federal revenues for the full cost of the programs. 16/

---

16. It should be noted that there is an entirely separate unemployment compensation program for railroad employees, administered by the Federal Railroad Retirement Board.

The system of administration is subjected to great stress during periods of high unemployment. Late payments, erroneous payments, lax enforcement of the work test, decreased provision of employment services--all may result from this stress. Therefore, it is both useful and important to analyze means to counteract this possible cyclical deterioration of the quality of this system. In addition, there are other administrative issues, such as calculating the effects of expanding the definition of what is considered "suitable work" for an unemployment compensation recipient.

However, these issues are only now being given the kind of rigorous, detailed study required to yield useful conclusions. Because administrative aspects of large programs can have a significant effect on program efficiency, it would be useful to see more policy related analysis forthcoming in this area.

CHAPTER VII

SOME ALTERNATIVE APPROACHES TOWARD CHANGING THE UNEMPLOYMENT COMPENSATION SYSTEM

There are many possible structural combinations and levels of the unemployment compensation system. However, certain specific combinations serve to illuminate the various approaches that can be taken in designing the system.

The first three combinations described below are extreme in the sense that they each embody one of these orientations in isolation from the others. Alternative forms of the system may contain elements derived from more than one viewpoint. The current unemployment compensation system is clearly such a hybrid form.

A Self-Financing Insurance System. The unemployment compensation system was originally designed to provide short-term relief to the temporarily and involuntarily unemployed. This relief was to be financed entirely from payroll tax contributions. A system embodying these benefit and financing orientations today might be achieved by the following changes:

- Increasing the system revenues through an increase in the tax base and/or an increase in the tax rate.
- Establishing a balance between revenues and benefit payments by tying increases in the wage base to increases in benefit levels.
- Decreasing the possibility of a need for cyclical borrowing from general federal funds by instituting reserve ratio requirements.
- Restricting coverage to those sectors that are approximately self-financing under the present experience rating system, or, alternatively, creating an unlimited experience rating system.
- Eliminating the extended benefits and federal supplemental benefits programs. This would eliminate most of the current need for general federal funds while still preserving the basic benefit duration in the permanent programs.

These changes in the unemployment compensation system would influence its effects in several ways. Costs to employers and employees would increase slightly as they assume a greater burden of the financing of the basic system. Federal budget outlays from general fund revenues would decline substantially as the principal users of these resources--the Extended Benefits and Supplemental Benefit Programs--would be eliminated. Outlays for other income assistance programs (e.g., food stamps) would go up to the extent that individuals who formerly participated in the eliminated unemployment compensation programs increased their participation in other programs. The financial condition of the unemployed would decline because the income assistance programs provide substantially lower levels of benefits than unemployment compensation. The decrease in benefit levels and duration that would result from the elimination of extended benefits and federal supplemental benefits would reduce the work disincentives resulting from the unemployment compensation system. Consequently, the unemployment rate would probably decline slightly.

Elimination of Unemployment Compensation and Resulting Reliance on Other Income Assistance. The unemployment compensation system was designed as one part of a set of programs targeted at specific groups deemed deserving of and needing support. Those persons who were able to work and had worked previously, but were unable to find suitable work for a time, were provided with a special mechanism through which benefits would be made available.

However, the passage of time has brought about an increase in the scope of income assistance programs. Some may view the previously employed as not now requiring or deserving a separate assistance mechanism. In this case the unemployment compensation system could be dismantled and the covered unemployed incorporated into the remainder of the current income assistance system.

Appendix B presents the calculations of the added income assistance costs that would be incurred by this change. The increase in such costs is approximately $1 billion, as against approximately $7 billion in unemployment compensation benefits for the comparable period. 17/ The observation to be drawn from this difference is that the covered unemployed are a different population from those currently eligible for income assistance and, in many cases, receive larger benefit payments than those available from the income transfer programs. However, this calculation does not include the costs of increased assistance that may occur in programs such as Medicaid and general assistance. And it does not include the costs of programs that do not now exist but might be created if the unemployment compensation system were abolished.

---

17. This $1 billion includes the state share of AFDC.

The elimination of the unemployment compensation system would result in other significant effects. Costs to employees and employers would diminish substantially and federal budget costs would decline to the extent that unemployment compensation outlays exceed the aggregate income assistance benefits received by former unemployment compensation beneficiaries. The financial condition of the unemployed would worsen significantly because of the substantial difference between income assistance and unemployment compensation benefits. Consequently the work disincentives created by unemployment compensation would be reduced and the unemployment rate would decline somewhat. The decline would exceed that resulting from simply shortening the duration of unemployment compensation benefits.

Finally, the unemployment compensation system acts as an automatic stabilizer because benefit payments exceed taxes in times of high unemployment. Elimination of this system would therefore exacerbate the effects of recessions. However, this negative effect would be lessened by the above-mentioned decrease in work disincentives, and countercyclical spending could be increased by appropriate monetary and fiscal policies.

Creation of a System With Universal Coverage Financed with General Federal Revenues. This unemployment compensation system would entail the following changes:

- Make universal coverage permanent.
- Eliminate the trust fund mechanism, transferring these financing obligations to general federal funds.
- Establish a federal gross wage replacement rate.

These changes might be motivated by a wide range of views. First, the previously employed may merit special consideration regardless of the amount of turnover present in their particular industries or firms. The problems related to their unstable employment should be ameliorated through general revenue support rather than by taxing the payrolls of the employers. General revenue financing would provide a more flexible source of support than trust funds for a program whose costs are strongly cyclical.

Federal benefit standards would mean that all covered workers in similar circumstances would receive the same benefit amounts, regardless of their state of residence.

The changes in costs resulting from the establishment of a universal, federally supported system of unemployment compensation would be substantial. Federal budget costs from general revenue funds would increase greatly especially during periods of high unemployment. Direct employer and employee costs could diminish given the end of the payroll tax. The impacts on the financial condition of the unemployed and the resulting work disincentives would depend on the generosity of the federally supported system. To the extent that net benefit levels and durations exceeded those extant with the current system the financial condition of the unemployed would be improved and their incentive to work could be diminished. The financial conditions and work disincentives of previously uncovered workers would clearly be increased.

A Combined System. Clearly an unemployment compensation system can be developed with a mixture of orientations or perceptions. A self-financing, insurance-based system can be utilized to provide short durations of benefits during periods of low unemployment and a general revenue fund financed system can be utilized to support longer durations of benefits during periods of high unemployment. Such a system would tend to provide greater benefits during periods of higher unemployment when work disincentive effects would be reduced given the general lack of job opportunities. The current unemployment compensation system is such a mixed-orientation system and others, with different benefit levels, durations, coverages and administrative practices, could be developed and implemented.

Table 17 illustrates the tradeoffs involved in choosing a particular form for the unemployment compensation system.

TABLE 17--RELATIVE PERFORMANCE LEVELS OF ALTERNATIVE UNEMPLOYMENT COMPENSATION SYSTEMS (RELATIVE TO THE CURRENT MIX SYSTEM)

	Effect on:			
System Orientation	Financial Condition of the Unemployed	Level of Unemployment	Direct Employer and Employee Cost	Federal General Revenue Costs
I Self-Financing Insurance	worsened	slightly lowered	increased	decreased substantially
II Elimination of Special Income Assistance for the Previously Employed	substantially worsened	lowered	decreased substantially	decreased
III Universal Coverage Financed with General Federal Revenues	improved on average	increased	decreased substantially	increased substantially

APPENDIX A

THE RELATIONSHIPS BETWEEN THE UNEMPLOYMENT COMPENSATION AND PUBLIC ASSISTANCE SYSTEMS

There are several reasons for considering the relationship between the unemployment compensation system and public assistance programs. If one of the results of unemployment compensation is an improvement in the financial condition of the unemployed, it is necessary to consider the joint effects of unemployment compensation and public assistance on this outcome. Similarly, if unemployment compensation increases unemployment through work disincentives, one needs to consider carefully the disincentives created by unemployment compensation and public assistance in unison. Regrettably, the data available to examine these joint and interactive effects are limited.

The primary overlaps between unemployment compensation and public assistance occur with the food stamp and AFDC-UF 1/ programs. Estimates of the percentage of beneficiaries simultaneously receiving benefits from several programs are presented in two sources.

The first source is the UI exhaustee study by Mathematica Policy Research, which was referred to on pages 29 and 30. The data from the study is summarized in Table A-1. Again it should be borne in mind that the exhaustees have on average a different demographic profile than the average unemployment compensation recipient. The exhaustee population is older, disproportionately female, and probably has smaller family sizes than the total claimant population. For different public assistance programs this will result in different biases in the overlap estimates resulting from using the exhaustee estimates.

The second source of data on program overlaps is a paper done for the Subcommittee on Fiscal Policy of the Joint Economic Committee (JEC). 2/ This study provides data on program overlaps for the late 1960s. It has the advantage of dealing directly with the unemployment compensation claimant population, but it has the disadvantage of resulting from an effort to combine data from a variety of nonsimilar sources. The following is a brief discussion of public assistance programs and their interaction with the unemployment compensation system.

---

1. Aid to Families with Dependent Children with Unemployed Fathers.

2. "Public Income Transfer Programs: The Incidence of Multiple Benefits and the Issues Raised by Their Receipt," Studies in Public Welfare, Paper No. 1, Subcommittee on Fiscal Policy, JEC, April 10, 1972.

TABLE A-1—OVERLAP OF UNEMPLOYMENT COMPENSATION
AND TRANSFER PROGRAM RECIPIENTS

	Percent of Exhaustee Households Receiving Transfer Payments;			
	At Exhaustion (WAVE I)		Four Months Following Exhaustion (WAVE II)	
	White	Nonwhite	White	Nonwhite
UI For Other Family Members	1.6	1.3	3.4	4.5
Supplemental Unemployment Benefits (SUB)	2.1	1.5	2.0	2.0
Social Security and Railroad Retirement	21.8	10.7	24.3	9.1
Veterans Benefits and GI Bill	4.1	3.0	4.8	3.5
Other Social Security And Veterans Benefits	0.7	0.4	0.8	0.4
Private, Civil Service, Military and Other Pensions	12.8	2.9	13.7	2.9
Workers Compensation	0.9	4.1	1.0	0.6
AFDC and AFDC-UF	1.9	4.2	2.2	8.1
SSI			0.9	0.9
General Assistance	0.3	2.9	2.0	7.7
Other Public Assistance	0.6	0.9	0.6	0.6
Food Stamps	3.4	10.9	9.1	23.6
Subsidized Housing	1.4	10.0	2.1	9.8

SOURCE: A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research Project Report No. 76-01 (1976), Tables VII.1, VII.2, VII.4, VII.5.

Food Stamps. The food stamp program is widely available. Benefit levels are determined by adjusted net income, family size, and an asset test. The program treats unemployment compensation benefits as income, with benefits being taxed away at approximately a 30 percent rate (i.e., for each dollar of unemployment compensation, food stamps benefits are reduced by 30 cents). About 3.4 percent of the white exhaustees and 10.9 percent of the nonwhite exhaustees received unemployment compensation and food stamps concurrently.

Supplemental Security Income. SSI provides direct coverage to persons who are age sixty-five or blind or disabled, depending upon their personal income and resources. After an initial $20/month deduction, SSI benefits are reduced dollar-for-dollar for unemployment compensation benefits. In the Mathematica study approximately 1 percent of the exhaustees received unemployment compensation and SSI concurrently. According to the JEC study, less than 1 percent of the unemployment compensation beneficiaries also received SSI benefits, and less than 1 percent of SSI beneficiaries also received unemployment benefits.

Medicaid. To be eligible for Medicaid, a person must either be on SSI or AFDC or have high enough medical care costs to be classified as "medically needy."

Social Security, Medicare. Unemployment compensation is ignored in determining payment levels for social security. However, earned income is taxed at a 50 percent rate after $2,400. This differential treatment of earned versus unearned income may provide some incentive for social security recipients to remain on unemployment compensation rather than return to employment.

Railroad Retirement (Tier I), Public Employee Retirement and Military Pensions. Other income has no effect on benefit levels of civil service and military retirement programs. Railroad Retirement treats income in the same manner as does social security.

General Assistance. General public assistance programs are individual state programs, with no federal involvement. Data on them and their potential overlap with unemployment compensation are not available. However, informed observers believe that these programs' benefits are probably reduced dollar-for-dollar for unemployment compensation benefits.

Trade Adjustment Assistance. Workers in industries affected by import competition are eligible for benefits that will influence the performance and costs of the unemployment compensation system. Eligible workers include any group of three or more persons who can show that import competition did or will contribute significantly to their unemployment or under-employment. They must also have worked in the adversely affected industry 26 of the 52 preceding weeks. If certified eligible, workers may receive the following benefits:

> "Up to 70% of the employee's average weekly wage may be paid for up to 52 weeks. These payments may supplement UI benefits but may not of themselves, or when combined with UI payments, exceed $180/week. Workers over 60 or in training may receive an extra 26 weeks of payments." 3/

---

3. An Assessment of Selected Manpower Efforts, National Commission for Manpower Policy, September 9, 1975.

Unemployment Compensation and AFDC-UF; A Major Interaction

The relationship between unemployment compensation and AFDC-UF is currently in a state of flux. Because the nature of this relationship may have effects on program characteristics, including costs, the current situation will be explored in detail.

Philbrook v. Glodgett

Current federal law denies AFDC-UF benefits to a dependent child "with respect to any week for which such child's father receives unemployment compensation." Claiming legislative intent, HEW and the state agencies had been administering the AFDC-UF program by disqualifying a dependent whose father is eligible for unemployment compensation benefits before receiving AFDC-UF. On June 9, 1975, in the case of Philbrook v. Glodgett (421 US 707), the Supreme Court upheld the District Court decision that fathers cannot be excluded from AFDC merely because they are eligible for unemployment compensation. Consequently, the current situation is that each eligible father can decide whether to receive unemployment compensation or AFDC-UF assistance.

Legislation is now pending before Congress (H.R. 13272) which would require persons to apply first for unemployment compensation, with the states supplementing the unemployment benefits up to the level of the AFDC benefit for which the persons are eligible.

Impact on Transfer Programs of Changes in Unemployment Compensation Program Characteristics

It is difficult to obtain data appropriate for a detailed analysis of the effects of unemployment compensation system characteristics on transfer programs. Consequently, it will not be possible in this appendix to present numerical estimates of the impacts on transfer programs of changes in the unemployment compensation system. However, it is possible to describe the direction, nature, and possibly the order of magnitude of the effects of such changes.

Coverage

The primary groups to whom coverage will be extended in 1978 are state and local employees, domestic workers, and agricultural workers. As noted earlier, domestic and agricultural workers tend to be low wage workers. Therefore, their potential unemployment benefit levels would probably be low, particularly in comparison with the AFDC-medicaid package for which many of the workers may be eligible. Thus, the number of domestic and agricultural workers who elect to receive unemployment compensation benefits may be significantly less than the number who are eligible.

A possible perverse effect of this extension of coverage to low-wage workers should also be mentioned. Extension of coverage results in new employer payroll taxes. The payroll taxes are related to the number of covered workers and the wage rates they are paid. Therefore, the payroll tax is probably considered by the employer as part of the overall cost of hiring labor. So the "employer" tax may partly be shifted to the employee--the employee is paid a combination of a wage and unemployment compensation coverage, for which coverage he has sacrificed some of his take-home pay.

Under current policy, if newly covered workers having dependents become unemployed and elect to receive the AFDC-medicaid package, then they will receive no unemployment compensation benefits. However, under the assumptions of the preceding paragraph, they will still have borne at least part of the costs of the unemployment compensation deductions. Therefore, extending coverage to certain low-wage workers could have the result of making them worse off.

It should be reemphasized, however, that many newly covered workers may be ineligible for AFDC, and others may have high enough unemployment compensation benefit levels to make the other programs less attractive.

Benefit Levels

Changes in benefit levels will have fairly straight forward effects. Where recipients may receive benefits from more than one program concurrently, reduced costs and caseloads for these transfer programs may occur (depending on their treatment of income) as a result of increased unemployment compensation benefit levels. In the case of AFDC more joint eligibles would opt for unemployment compensation, also resulting in reduced costs and caseloads for AFDC. Decreasing unemployment compensation benefit levels would have the opposite effects. Estimates of the magnitudes of these effects are not available.

Duration of Benefits

Increasing (decreasing) the duration of benefits will obviously delay (bring forward) recipients' attempts to receive (or increase) other forms of assistance. Under prolonged adverse economic conditions, the number of potential unemployment compensation exhaustees can loom quite large. For example, even in the presence of Federal Supplemental Benefits and Special Unemployment Assistance, the Labor Department estimates that in 1976 over 1.5 million persons will exhaust all unemployment benefits.

Experience Rating System

Although the experience rating system is part of the unemployment compensation financing mechanism, it can have ramifications on program interaction. Under the Glodgett decision, an eligible person may choose between AFDC-UF and unemployment compensation. Under experience rating, an employer's contributions to unemployment compensation are, within limits, a function of amounts paid out in claims. Therefore, employers may have an incentive to encourage unemployed workers to take AFDC instead of unemployment compensation. (Again, pending legislation may eliminate this option.)

APPENDIX B

COST OF PUBLIC ASSISTANCE IN THE ABSENCE OF UNEMPLOYMENT COMPENSATION

The data available to estimate the impact of an absence of unemployment compensation on public assistance program costs are quite limited. However, CBO attempted to derive an estimate using two methods. The first method utilizes the Mathematica Policy Research study of exhaustees described in Appendix A. The second method is rather rough and ready and requires some bold assumptions. Both methods yield estimates of the same order of magnitude. It should be emphasized that an order of magnitude is all that is intended in this exercise, and that even fairly large changes in some of the variables will not change the basic result.

In the following sections, CBO calculates estimates for AFDC, SSI, and Food Stamps, but not for the retirement programs. This is because benefit levels in the retirement programs are not a function of unearned income. Hence, program costs for these programs will remain substantially the same whether or not unemployment compensation benefits are being paid out.

Method I

In this method, it is assumed that unemployment compensation exhaustees are representative of recipients. Table A-1 in Appendix A lists the distribution of benefits from major programs for whites and nonwhites, both at the time of exhaustion of unemployment compensation benefits and four months later. In these calculations, CBO used the total participation rates listed in the "four months later" survey:

Percentage of UI Exhaustee Households Receiving Transfer Payments

White Exhaustees	
AFDC (including UF)	2.4%
SSI	0.9
Food Stamps	9.4
Nonwhite Exhaustees	
AFDC (including UF)	8.2%
SSI	0.9
Food Stamps	23.6

Although these rates include some persons who were already receiving other assistance while receiving unemployment compensation, it is assumed that these persons will receive a greater amount of such assistance if they are not receiving unemployment compensation.

Next, CBO obtained from generally available sources the number of insured unemployed in November 1974 (in thousands):

White	2,065
Nonwhite	359

When these figures were multiplied by the percentage participation figures, total caseloads were obtained. Next, average yearly benefits for AFDC, SSI, and Food Stamps were obtained by taking average monthly benefits for late 1974 and multiplying them by 12, yielding the following numbers:

	Average Yearly Benefits per Family
AFDC (including UF)	$ 2,456
SSI	1,176
Food Stamps	942

SOURCE: Handbook of Public Income Transfer Programs; 1975, Studies in Public Welfare, Paper No. 20, Joint Economic Committee (Washington, D.C. GPO, 1974).

When these average yearly benefits are multiplied by the program recipient numbers, CBO obtained estimated costs of welfare programs in the absence of unemployment compensation for 1974:

Estimated Program Costs for 1974
($ millions)

AFDC (including UF)	194
Food Stamps	263
SSI	26
TOTAL	483

SOURCE: Handbook of Public Income Transfer Programs: 1975, Studies in Public Welfare, Paper No. 20, Joint Economic Committee (Washington, D.C. GPO, 1974).

It should be noted that this estimate is subject to many biases on both sides. The exhaustee population is older, contains more women and nonwhites, and possibly has smaller family sizes than the recipient population. The average benefit amount for other public assistance programs may not be the correct number to use for this purpose. But even major changes in these factors would not change the result that, at most, $1 billion would be added to welfare costs if the unemployment compensation system did not exist. (For example, if AFDC caseloads are tripled, total program costs would still round off to $1 billion.)

Method II

Insured unemployed (thousands in November 1974) =	2,423
X 0.9 adjustment factor for removal of work disincentive =	2,181
X 0.3 adjustment factor for eligibility for AFDC, SSI, or Food Stamps =	654
X 0.8 adjustment for participation rate =	523
X $1,750 average annual payment for all programs =	$916 million

$916 million in additional AFDC, SSI, and Food Stamp program costs in absence of unemployment compensation.

APPENDIX C

SUMMARY OF IMPACT OF UNEMPLOYMENT COMPENSATION

- Financial Condition of the Unemployed

  Covers 68 million workers (CY 1975).
  Over 10 million unemployed receive benefits (CY 1975).

- Levels of Employment and Unemployment

  The unemployment rate is increased by between 0.2 and 0.75 percentage points.

- Costs to Employers/Employees

  Costs about $6 billion annually in the form of taxes on employers (CY 1975).

- Direct Federal Budget Costs

  Total budget outlays were approximately $19 billion in fiscal year 1976.

In addition, the following budgetary effects occur:

- A tax expenditure of $3.5 billion in fiscal year 1976.
- A saving of roughly $1 billion or less in welfare (CY 1974).
- Automatic stabilization through the federal budget.

APPENDIX D

PROVISIONS OF PUBLIC LAW 94-566

In October of 1976, President Ford signed H.R. 10210, a bill creating major changes in the unemployment compensation system. The bill became Public Law 94-566.

The major provisions of the law are described below. The effective date is January 1, 1978, except for the increase in the FUTA tax rate which will take effect on January 1, 1977.

Coverage Provisions

- Extends coverage to all nonelected state and local government employees (with some exceptions).

- Extends coverage to agricultural workers of employers with ten or more employees during 20 weeks of the year or a quarterly payroll of $20,000.

- Extends coverage to domestic workers of employers with a quarterly payroll of at least $1,000.

Financing Provisions

- Raises the federal taxable wage base from $4,200 to $6,000.

- Raises the net FUTA rate from 0.5 percent to 0.7 percent for as long as there are loans outstanding in the EUCA account at the federal level.

Other Provisions

- Modifies the trigger for extended benefits so that when the unenployment rate reaches 5 percent in a state, the state may waive the requirement that its unemployment rate be at least 20 percent higher than the corresponding rate for the two preceding years.

- Denies summer benefits to school employees with contracts for the forthcoming term, and school employees with a "reasonable assurance" of post-vacation employment.

- Requires states to reduce unemployment conpensation benefits for retired individuals by the amount of any public or private pension based on a claimant's previous employment. This provision becomes effective on October 1, 1979.