6. The socialized costs should be equitably spread out among all employers. Socialized costs include benefits that are paid out that are not charged back to any employers, benefits paid to claimants whose employer is out of business, and benefits paid to claimants whose employer is a deficit or red line employer. A deficit or red line employer is one whose employees draw more in unemployment compensation benefits in total than the tax paid by the employer (10).

With respect to timing vis-a-vis the business cycle, various proposals, many of which have been implemented by one or more individual states, have been suggested.

Divergences between taxable payroll and total payroll, it is said, weaken the countercyclical effect of the UI tax, because variations in payroll are more apt to take place in the gap between the taxable total and the actual total. For example, an employee laid off for one or two months during the year very well might earn the same amount of taxable wages as one employed throughout the year. Thus, in both upswing and downswing, layoffs and recalls might make little, if any, difference in an individual employer's annual taxable wages, generally an important element in the rate formula. To some extent the recent increase in the Federal wage base will reduce this kind of problem, although it must be noted that the new $6,000 minimum base is still only slightly more than half the average total wage in covered employment in 1978.

Another suggestion has been to increase tax rates on the business cycle upswing. Thus, an increased rate would automatically be triggered for an employer with a rapidly rising payroll, on grounds that at such a time a firm would be in a position of relative economic strength, and its potential liabilities would be increasing more rapidly than its reserves. A number of states used such a plan during World War II, but the method has not been applied since. The inverse of this approach, decreasing taxes on the downswing, has been applied in Wisconsin. Other suggestions include tax credits and a uniform surtax to be activated by some economic indicator.

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10. Statement of Edward H. Kay, Jr. before the Louisiana Chapter of the I.A.P.E.S. Employer Institute, October 12, 1978, Metairie, Louisiana.

V.

UNEMPLOYMENT INSURANCE AND THE BUSINESS CYCLE

Questions regarding the appropriate length for extended unemployment benefits, and the reasonable trigger mechanism to activate such benefits, have occupied many hours of legislative investigation and discussion over the past few years. The issues are by no means simple, and the "right" course has at no time been clear. But the perception of jobless millions has tended to overshadow other considerations, with relatively little attention directed to possible effects of the unemployment insurance system on the business cycle.

UI Benefits and Taxes in Recessions (1)

Over the past three decades, both total benefits and total taxes have fluctuated considerably in the course of their inexorable upward climb (Table 11). As might be expected, benefits have tended to rise in recessionary periods, often spectacularly, and to drop back during years of economic expansion. Tax collections, on the other hand, move in a different phase because of the rise or fall in taxable covered employment, as well as the UI reserve requirements. While taxes are more likely to rise than fall in the initial phase of business cycle expansion, the upward movement may be interrupted as state reserves build up and tax rates are adjusted downward. In general, transfers of funds to private individuals are accelerated during recessions, a process which current thinking on business cycle theory would find desirable (2). At the same time, however, it has frequently happened that in downturns tax payments increase--just the opposite of what seems appropriate at such a time.

The timing of the stimulating effect of the infusion of money into the economy vis-a-vis the dampening effect of a net withdrawal can be seen clearly in the column in Table 11

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1. It should be noted that annual data, discussed here and shown in Table 11, are less effective in the analysis of cyclical effects than are monthly or quarterly data.

2. The economic effects depend on what happens to funds received as surpluses and the source of funds when deficits are being incurred. Monetary policy can reinforce or offset these effects or be essentially neutral.

Table 11

UNEMPLOYMENT TAXES COLLECTED, BENEFITS PAID, AND BUSINESS CYCLE TURNING POINTS
Calendar Years 1945 - 1979
(Dollar Amounts in Millions)

Year[a]	Taxes collected[b]	Benefits paid[c]	Taxes minus benefits: Deficit	Taxes minus benefits: Surplus	Business cycle turning points
1945 P,T	$ 1,315	$ 448		$ +867	Peak (Feb. 1945) Trough (Oct. 1945)
1946 E	1,216	1,133		+83	
1947 E	1,384	829		+555	
1948 P	1,218	850		+368	Peak (Nov. 1948)
1949 T	1,256	1,865	$ -609		Trough (Oct. 1949)
1950 E	1,473	1,457		+16	
1951 E	1,754	884		+870	
1952 E	1,638	1,068		+570	
1953 P	1,611	1,046		+565	Peak (July 1953)
1954 T	1,394	2,221	-827		Trough (May 1954)
1955 E	1,550	1,488		+62	
1956 E	1,872	1,493		+379	
1957 P	1,941	1,868		+73	Peak (Aug. 1957)
1958 T	1,935	4,078	-2,143		Trough (April 1958)
1959 E	2,512	2,697	-185		
1960 P	2,808	2,941	-133		Peak (April 1960)
1961 T	3,073	4,236	-1,163		Trough (Feb. 1961)
1962 E	4,104	3,051		+1,053	
1963 E	4,037	2,911		+1,126	
1964 E	3,831	2,630		+1,201	
1965 E	3,783	2,250		+1,533	
1966 E	3,757	1,834		+1,923	
1967 E	3,356	2,149		+1,207	
1968 E	3,306	2,091		+1,215	
1969 P	3,329	2,196		+1,133	Peak (Dec. 1969)
1970 T	3,475	3,907	-432		Trough (Nov. 1970)
1971 E	3,682	5,687	-2,005		
1972 E	5,470	5,487	-17		
1973 P	6,732	4,158		+2,574	Peak (Nov. 1973)
1974 C	6,832	6,491		+341	
1975 T	6,687	16,453	-9,766		Trough (March 1975)
1976 E	9,771	14,169	-4,398		
1977 E	12,077	11,512		+565	
1978 E	14,836	8,713		+6,123	
1979 E	15,906	9,243		+6,663	

a. Initials after the year indicate that there occurred during the year a business cycle peak (P), a trough (T), a period of expansion (E), or a period of contraction (C).

b. Includes state, Federal, and railroad tax collections; excludes employee portion of tax in several states.

c. Excludes benefits for Federal employees, paid from general funds effective 1955. Includes regular, extended, and Federal supplemental benefits.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, The National Income and Product Accounts of the United States, 1929-74; Survey of Current Business, July 1979, and unpublished data; and Business Conditions Digest, July 1979.

showing the annual difference between UI benefit payments and taxes. The net effect of UI benefits and taxes seems generally in a direction advantageous for the moderation of cyclical swings. The unemployment rate--total and insured--is a leading indicator of a forthcoming cyclical downturn, but tends to lag when comprehensive economic measures pull out of a recession (3).

It may be, of course, that overall infusions or withdrawals of funds are not the only relevant consideration. There is, first of all, the human question of whether UI benefits do an adequate job in providing income security to span jobless periods. Higher total benefits do not necessarily mean sufficiently protected workers, since increased covered unemployment alone would raise total figures. A more useful guide might be the pattern of claimants exhausting their benefits (Table 12). From the late 1940s onwards, the percent of claimants exhausting benefits, taken either with reference to all first-benefit payments or to total employment, routinely increases during a downturn and drops during recovery. Generally, during recessions about 30 percent of claimants have exhausted benefits. How low the percentage drops thereafter appears to depend on the length of the subsequent prosperity. The 1973-1975 recession departed from this pattern, however, perhaps as a consequence of extended benefits. In 1975, exhaustees as a percent of those receiving first payments rose to 38 percent, the highest rate since 1946. Also in 1975, 95 percent of exhaustees under regular programs received extended benefits. Only 22 percent of regular program claimants exhausted extended benefits--an unusually low percentage of exhaustees for the trough of a recession compared to prior years, when extended benefits were not available.

Considered from the point of view of total covered employment, the percent of exhaustees varies by several percentage points between periods of prosperity and recession. It has peaked at about 6 percent in recessions and dropped to about 2 percent in upturns. The introduction of extended benefits, together with the severity of the 1973-75 downturn, coincides with a change in pattern: in 1975, 7 percent of covered employment exhausted regular benefits, and 4 percent exhausted extended benefits.

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3. U.S. Department of Commerce, Bureau of Economic Analysis, Business Conditions Digest, March 1980, p. 6. These effects are somewhat exacerbated as a recession comes to an end by the fact that the average duration of unemployment lags behind the general recovery.

Table 12

CLAIMANTS EXHAUSTING BENEFITS, AS PERCENT
OF FIRST PAYMENTS AND OF AVERAGE COVERED EMPLOYMENT
1940 - 1978

		Claimants exhausting benefits		
Year	Number (000)	As percent of first payments	As percent of covered employment	Business cycle turning points
Regular benefits:				
1940	2,590	50.6	11.2	
1941	1,544	45.6	5.8	
1942	1,078	34.9	3.7	
1943	194	25.5	0.6	
1944	102	20.2	0.3	
1945	250	18.1	0.9	Peak (Feb. 1945) Trough (Oct. 1945)
1946	1,986	38.7	6.6	
1947	1,272	30.7	3.9	
1948	1,028	27.5	3.1	Peak (Nov. 1948)
1949	1,935	29.1	6.1	Trough (Oct. 1949)
1950	1,853	30.5	5.6	
1951	811	20.4	2.3	
1952	931	20.3	2.6	
1953	764	20.8	2.1	Peak (July 1953)
1954	1,769	26.8	5.0	Trough (May 1954)
1955	1,272	26.1	3.5	
1956	980	21.5	2.5	
1957	1,138	22.7	2.9	Peak (Aug. 1957)
1958	2,505	31.0	6.6	Trough (April 1958)
1959	1,675	29.6	4.2	
1960	1,604	26.1	4.0	Peak (April 1960)
1961	2,366	30.4	5.9	Trough (Feb. 1961)
1962	1,638	27.4	4.0	
1963	1,572	25.3	3.7	
1964	1,371	23.8	3.2	
1965	1,087	21.5	2.4	
1966	781	18.0	1.6	
1967	867	19.3	1.8	
1968	848	19.6	1.7	
1969	811	19.8	1.5	Peak (Dec. 1969)
1970	1,303	24.4	2.5	Trough (Nov. 1970)
1971	2,044	30.5	3.9	
1972	1,813	28.9	3.2	
1973	1,495	27.6	2.5	Peak (Nov. 1973)
1974	1,926	31.0	3.2	
1975	4,195	37.8	7.2	Trough (March 1975)
1976	3,270	37.8	5.4	
1977	2,850	33.2	4.5	
1978	2,030	26.7	3.0	
Extended benefits[a]:				
1971	714	50.3	1.4	
1972	539	49.5	1.0	
1973	176	72.1	0.3	Peak (Nov. 1973)
1974	468	51.1	0.8	
1975	2,477	61.7	4.2	Trough (March 1975)
1976	2,406	74.0	3.9	
1977	1,761	66.3	2.8	
1978	549	57.9	0.1	

a. Computations not strictly comparable with those for regular benefits.

Source: U.S. Department of Labor, Handbook of Unemployment Insurance Financial Data, 1938-1976 and supplements; and Tax Foundation computations.

Hard and fast conclusions cannot be drawn from these data, however, since there is no information on the employment history of exhaustees subsequent to benefit exhaustion. Some may remain without jobs for a very long period or even drop out of the labor market altogether, while others may be back at work the very next day. Nonetheless, these trends suggest that significantly more claimants than would prefer to do so exhaust benefits during downturns in the business cycle.

The other side of the picture is the effect of UI taxes on employer costs during recessions. Ideally, a tax which supports an anticyclical program would go down during recessions and increase during expansions. Historically, UI tax collections have moved in ways which sometimes have moderated and sometimes have exacerbated the business cycle. During the 27 years of general business expansion from 1946 through 1979, taxes increased over the previous year in 17 years and declined in 10 years. During the 7 recessionary years in the postwar period, taxes rose in 4 years and declined in 3 years (see Table 11). In sum, UI tax movements have not served as a particularly useful countercyclical tool, and at times even may have aggravated inflationary tendencies and retarded recoveries.

Extended and Supplemental Benefit Programs: Legislative History

The argument regarding the appropriate duration of benefits may never be settled. Some say benefit duration should relate closely to the financial capabilities of the UI program, and should never be so long as to strain the system. Others believe the potential work disincentive effects of lengthy benefit periods are of paramount importance. Still others feel that unemployment benefits, like disability benefits, should be available for the duration of unemployment, however long that might be (4). In any event, many have felt in recent years that recessionary conditions justify extensions of benefit duration. This latter premise is now incorporated into Federal law as a permanent program under the Extended Unemployment Compensation Act of 1970.

Even before the first temporary Federal legislation in 1958, California, Connecticut, Hawaii, Idaho, Illinois, North Carolina, Pennsylvania, Vermont, and Puerto Rico had offered

4. Five foreign countries--Australia, Belgium, France, New Zealand, and Yugoslavia--allow unlimited duration, subject to various conditions.

extended benefit programs. The first Federal legislation was considered an emergency program, enacted in response to the unusually high number of claimants who were exhausting their benefits during that recessionary period. The program, financed by Federal loans to participating states, did not go into effect until June of 1958, somewhat after the economy had begun its upward turn, but, even so, 17 states participated in the program. Extended benefits were half the amount of the regular benefit, for a maximum of 13 weeks.

A second temporary program was enacted in 1961, again offering 50 percent of the regular benefits for 13 additional weeks. In this case the benefits were financed by a temporary additional Federal tax (see Table 1).

In 1970, Congress passed the Extended Unemployment Compensation Act. In provisions for financing and duration, this act was similar to the 1961 program. For the first time, full benefits were authorized. Its most distinctive feature, however, was that it was designed as a permanent response to recession situations, providing for a program that becomes operative when certain "triggers"--i.e., specified conditions associated with recessions--appear. This first legislation specified that extended benefits would go into effect whenever a state's unemployment rate averaged 4 percent or more for 13 consecutive weeks and was at least 120 percent of the average rate for the corresponding 13-week period in the two preceding years. Alternatively, the program could be initiated by a three-month period of at least 4.5 percent unemployment nationwide. The costs of the extended benefits (EB) program are shared equally by Federal and state governments from employer payroll tax receipts.

Subsequent legislation in the 1970s further lengthened the period for which benefits could be paid under certain circumstances. (See Table 1.) The concept of "emergency" benefit weeks was introduced in 1972--i.e., a benefit period beyond the 13-week extended benefits, for a maximum of 52 weeks (26 weeks of regular benefits, 13 extended and 13 emergency). The program was in effect from January 1972 through March 1973. It was financed by an additional Federal payroll tax of 0.08 percent in 1973.

In late 1974 Congress authorized another emergency benefits program, known as Federal Supplemental Benefits (FSB), which remained in effect through October 1977, with a three-month phase-out lasting through January 1978. While the program was in effect, both the trigger mechanism and the duration of benefits were modified on several occasions. During one phase, which terminated in March 1977, supplemental benefits of 26 weeks' duration were authorized, for a total of 65 weeks. From its inception the FSB program was financed entirely by the Federal government, first through advances from Treasury funds which were to be repaid from future Federal UI taxes, and finally (beginning in April 1977) from general revenues.

Difficulties with the Trigger

The mechanism which activates additional benefit periods exerts a major bearing on the effectiveness of the entire program. Special programs must come into effect while severe problems exist, not afterwards, if they are to be of real value. Similarly, such programs must become dormant when they are not really needed if excessive costs are to be avoided. To devise a trigger which will meet both conditions has proved to be by no means simple.

Conflicting Signals. The difficulties that can arise in connection with the use of on- and off-activators is vividly illustrated by the situation in 1972. At that time, one set of state conditions could trigger in extended benefits; another, emergency benefits; and a nationwide unemployment rate below 4.5 percent could precipitate extended benefits. The "bizarre results" are described by Merrill G. Murray:

> Under the program authorized by the 1970 Act, states could be triggered on as early as October 10, 1970, while the nationwide benefits could not be triggered on until January 1, 1972. A total of 22 states had triggered on before the nationwide extended benefits program was triggered on, and some of these had already triggered off before that time. Then, nationwide extended benefits were triggered on for only three months, since the national insured unemployment rate dropped below 4.5 percent in December 1971, the month before nationwide extended benefits became payable, and continued below 4.5 percent in January and February 1972. Thus, extended benefits were being paid throughout the country during a period when the insured unemployment rate was lower than the level considered critical. When nationwide extended benefits were triggered off in the week of March 5-11, thus stopping those benefits by April 1, 19 states were still triggered on by their own state laws and so continued paying

> extended benefits after April 1. Of these, 10 also met the trigger required for paying temporary compensation. Nine states, although their state triggers were not on for extended benefits under the 1970 Act, were triggered on for TC, including one state triggered on in April...(5)

Major difficulty arose as a result of the requirement that the trigger-unemployment level in a state should meet a specified level and in addition be 20 percent higher than the state's unemployment in a corresponding prior period. The intent of such a restriction, of course, was to avoid initiating special programs merely in response to ordinary seasonal unemployment (6). What was not anticipated was that such a regulation could work a hardship in periods of prolonged recession. When heavy unemployment persists for more than a year, the unemployment rate must worsen, no matter how high it was initially, for the program to remain in effect. Thus, the emergency program can be cut off at a time when unemployment problems are severe and prolonged. Various approaches have been tried for the solution of this problem: temporarily waiving the 120 percent requirement to meet a specific situation, waiving the requirement in connection with a program calling for a relatively higher unemployment rate, and bringing in a compensating program when a prior program has been suspended because of failure to meet the 120 percent requirement. From 1970 through 1976 Congress waived the 120 percent factor on eight different occasions; a new law in 1976 gave states the same option when a state's unemployment rate is 5 percent or higher (7).

National versus State Triggers. Another difficulty arose with the trigger mechanism because the national indicator often was not sensitive to individual state conditions. In particular, it was argued that the national insured unemployment rate could reach 4.5 percent--the rate which until recently activated extended benefits in all states--as a result of high unemployment in a few industrialized states. Thus many states

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5. Merrill G. Murray, The Duration of Unemployment Benefits, Upjohn Institute, Kalamazoo, Michigan, 1974, p. 30.

6. The state trigger mechanisms are based on seasonally unadjusted state insured unemployment rates, whereas the national trigger is based on a seasonally adjusted rate.

7. A 1981 law raised the optional state trigger, as noted below.

could find themselves obligated to pay extended benefits when their unemployment rate was relatively low. For example, when the national trigger went into effect in July 1980, only 19 states had unemployment high enough to trigger it "on"; and when the national trigger went off in January 1981, only 25 states had high enough unemployment to continue extended benefits.

Beginning in the late 1970s the trigger mechanisms became the subject of extensive public debate. There were proposals to eliminate the national trigger entirely, and to give states even more latitude by permitting them the option of setting a benefit trigger at levels of state unemployment higher than the 5 percent then required by Federal law. Some opponents, on the other hand, held that the existing triggers should remain intact, because there can be severe pockets of unemployment in certain industries, affecting workers in many states, even though the overall national or state unemployment rates are not critically high.

For the time being, at least, proponents of greater state flexibility in determining the trigger rates activating extended benefits appear to have won their case. In the Omnibus Budget Reconciliation Act of 1981, Congress voted to eliminate the national trigger entirely (effective July 1, 1981) and to permit the states to establish an optional trigger (when the 120 percent factor is not met) when the unemployment rate reaches 6 percent, rather than 5 percent. The mandatory trigger rate was also raised. An extended benefits program will become effective when a state's insured unemployment rate averages 5 percent (formerly 4 percent) or more for 13 consecutive weeks and is at least 120 percent of the average in a similar period of the previous two years (8).

Insured Unemployment as an Economic Indicator. The use of state insured unemployment rates as activators of extended benefit programs has also been subject to a considerable degree of criticism. These rates are based on the number of current UI claimants divided by average insured employment during a 12-month period at least a half-year earlier. The resulting rate will not be realistic unless the economy is stable: if the 12-month base period was one in which employment was low because of a recession, the current insured unemployment rate will be unduly high; on the other hand, if the

8. The new state trigger will become effective September 25, 1982, by which time state legislatures will presumably have revised their existing laws.

base-year employment reflected conditions of a cyclical expansion, the current UI rate will be unrealistically low.

Moreover, the uninsured employment rate, as calculated, is flawed as a comparative measure of economic distress because it is sensitive to legislative and administrative influences which vary among states. More liberal state laws for such provisions as eligibility, disqualification, duration, waiting week, etc., can lead to a higher level of insured unemployment at a given time than the level that would be experienced under less liberal provisions.

According to William Papier, one critic of the use of the insured employment rate:

> Without advocating more or less liberal statutes this generalization seems fully warranted: the more liberal the state statute, the higher the insured unemployment rate. Liberal statutes, furthermore, are normally implemented by sympathetic administrations. There are times, however, when conservative statutes are liberally-construed, and vice versa. In any case, the volume of claimants can be and has been influenced by administrative policies, regulations, and interpretations. The insured unemployment rate is correspondingly affected, upward or downward....
>
> We could go on and on, listing ways in which non-economic factors can and do differently affect the insured unemployment rates of the various states. But enough have been cited, we believe, to document our major point--the insured unemployment rate is a poor statistical basis for measuring economic conditions in the various states (9).

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9. William Papier, "Replenishing State Unemployment Trust Funds from General Federal Revenues on the Basis of Unemployment Rates." Presented at hearings of the National Commission on Unemployment Compensation, Cleveland, Ohio, June 8, 1979. If a new cost equalization or reinsurance program were approved by Congress, Papier advocates use of the BLS measure of unemployment among heads of households.

Financing Problems. Among other effects, the extended and Federal supplemental benefit programs initiated in the 1970s contributed to financial problems in the Federal government and many states. These problems are discussed in the following section.

VI.

FINANCING PROBLEMS OF THE 1970s

The severity of the 1973-1975 recession, and the associated rise in unemployment, along with the new Federal laws in the 1970s lengthening benefit periods, placed uncommonly heavy demands on the financial resources of the UI system. These strains were exacerbated by normal growth in average benefits, and, in some states, by previously existing weaknesses in UI finances.

The amounts paid out in extended, supplemental, and regular benefits during the 1970s are shown in Table 13. Together, the extended and supplemental programs raised benefit payments during the period by over $15 billion, an amount equal to more than one-fifth of regular benefits during the same years. The Federal share of the programs was $10.8 billion, over 70 percent of the total. About $1 billion of this was paid from the Federal portion of the employer payroll tax, $8.9 billion was borrowed from general revenues, and the remainder was financed directly from Federal general revenues (1). The extended benefits program, financed on a 50-50 basis by Federal and state employer payroll taxes, at the same time added over $4.5 billion to the benefit claims to be financed by the states.

Financing problems during the 1970s led 25 states to borrow from the Federal trust fund amounts totaling more than $6 billion. (See Table 14.) These loans are available interest-free under provisions of Federal law. While some states had borrowed during the 1950s and 1960s, both the number of states and the dollar amount of the loans were relatively small. The unusual build-up of loan balances was concentrated in 1975 and 1976, when new loans to the states totaled $3.3 billion; by March 1980, an additional $2.5 billion had been advanced to states.

Under the original law, the states were required to begin to repay their loans within approximately two years or to

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1. As noted in the last section, Congress approved general revenue financing of the FSB program from April 1977 through its termination in January 1978; previously the program had been financed largely by borrowing, which was to have been repaid from future Federal UI tax receipts.

Table 13

UNEMPLOYMENT BENEFITS UNDER REGULAR, EXTENDED, AND FEDERAL SUPPLEMENTAL BENEFIT PROGRAMS
Selected Years, 1970 - 1979[a]
(Millions)

	Total benefits	Extended and supplemental benefits[b]			Regular benefits
		Total	Extended	Supplemental	
1970.......	$ 3,847	$ --	$ --	$ --	$ 3,847
1971.......	5,616	664	664	--	4,952
1972.......	4,966	482	482	--	4,484
1973.......	4,149	143	143	--	4,006
1974.......	6,517	539	539	--	5,978
1975.......	16,372	4,618	2,494	2,124	11,754
1976.......	14,095	5,122	2,293	2,829	8,973
1977.......	11,360	3,015	1,764	1,251	8,345
1978.......	8,402	692	692	--	7,710
1979.......	9,500	200	200	--	9,300
Total, 1971-1979..	84,824	15,475	9,271	6,204	69,349

a. Data for 1979 are preliminary.

b. Costs of extended benefits are shared 50-50 by Federal and state governments; supplemental benefits are paid by Federal government.

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

Table 14

ADVANCES TO STATES FROM FEDERAL UNEMPLOYMENT ACCOUNT
1972 - March 31, 1980
(Dollar Amounts in Millions)

State	Advances, 1972 - March 31, 1980: Amount	Advances, 1972 - March 31, 1980: Number of years	Repayments	Outstanding, April 1, 1980: Amount	Outstanding, April 1, 1980: Percent of 1978 taxable wage
Alabama	$ 56.7	3	$ 56.7	0	--
Arkansas	30.0	2	30.0	0	--
Connecticut	514.0	7	143.1	$ 370.9	5.9
Delaware	47.0	4	2.0	45.0	4.1
District of Columbia	73.5	5	8.0	65.5	3.9
Florida	42.0	2	42.0	0	--
Hawaii	22.5	1	22.5	0	--
Illinois	946.5	4	0	946.5	4.0
Maine	36.4	4	0	36.4	2.4
Maryland	62.6	2	62.6	0	--
Massachusetts	265.0	2	33.3	231.7	2.1
Michigan	859.0	4	624.0	235.0	1.4
Minnesota	172.0	3	172.0	0	--
Montana	10.5	3	3.4	7.1	0.7
Nevada	7.6	1	7.6	0	--
New Jersey	734.9	4	83.0	651.9	4.6
New York	335.8	2	335.8	0	--
Ohio	1.9	1	1.9	0	--
Oregon	18.5	1	18.5	0	--
Pennsylvania	1,364.3	6	42.3	1,322.0	6.2
Puerto Rico	88.7	4	0	88.7	2.7
Rhode Island	126.8	6	8.0	118.8	6.9
Vermont	47.7	4	7.0	40.7	5.1
Virgin Islands	10.9	3	0.5	10.4	10.6
Washington	149.4	4	149.4	0	--
Total	6,024.0	--	1,853.6	4,170.4	1.0

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

suffer a penalty Federal tax (2). Congress, in successive acts, extended the deferral authority until 1980, provided the states met certain financing requirements.

By early 1980, 11 of the 25 jurisdictions which had borrowed had repaid their loans, and 11 others had made partial payments. (See Table 14.) About $4.2 billion in debts was still outstanding in 15 states. More than nine-tenths of the total was owed by seven industrial states--Pennsylvania, $1,322 million; Illinois, $946 million; New Jersey, $651 million; Connecticut, $370 million; Michigan, $235 million; and Massachusetts, $231 million. Also in 1980, six states began repaying their loans through the penalty tax--a reduction in the employer's credit against the Federal tax (3).

By the time the drains on the financial resources of the UI system had become widely apparent, a host of proposals for shoring up the finances of the system began to surface. While the dividing lines are not always distinct, the proposals generally fall into four categories: 1) the retroactive funding of Federal supplemental benefits; 2) the retroactive funding of certain portions of the Federal and state shares of extended benefits; 3) easing the pressures on state financing resulting from the build-up of debt; 4) revising provisions concerning Federal loans to states; and 5) introducing new economies in the overall benefit programs, generally by imposing more Federal standards.

While a thorough discussion of the issues raised, and even of the proposals themselves, lies beyond the scope of this study, some background may prove useful.

Funding of Federal Supplemental Benefits

During the period from January 1975 through March 1977 the Federal unemployment trust fund ran up a debt of $5.8 bil-

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2. The penalty tax was incurred if, after two years, a state did not repay the entire amount of its loan; the tax was imposed on all employers in the state at the rate of at least 0.3% per year until sufficient revenues had been raised to repay the loan in full. The tax would rise from 0.7% to 1.0%, 1.3%, 1.6%, etc. in successive years. As discussed later in this section, Congress modified these provisions in 1981.

3. These states were Connecticut, Delaware, District of Columbia, Pennsylvania, Rhode Island, and Vermont.

lion for benefits paid under the supplemental benefits program (FSB). Under existing law, this debt remains an obligation of future Federal payroll taxes on employers. It has been proposed that the debt be cancelled and that the burden of eventual repayment be transferred to general Federal revenues.

The principal rationale for such action is that, after a person has exhausted regular and extended benefits, his unemployment can no longer be attributed to his previous employers, and they in turn should not be required to pay further payroll taxes to finance added benefits. In its recent deliberations concerning FSB programs, Congress has apparently adopted this principle. In the last such program, which began in April 1977 and lasted until early 1978, Congress provided that Federal general revenues would pay for the program in full. In 1980, both houses of Congress approved a new FSB program, as recommended by President Jimmy Carter, which would have been financed by general revenues. (The measure, however, died in conference.)

There appears to be a growing consensus that the present unemployment insurance system is not the proper vehicle for dealing with unemployment which lasts beyond the 39 weeks generally provided by the regular and extended programs. The proposal to transfer the costs of the existing FSB debt to general revenues (i.e., taxpayers at large), thus enjoys broad support from business, labor, and others. The notion was, in fact, endorsed by the National Commission on Unemployment Insurance.

Retroactive Funding of Certain Extended Benefits

From January 1975 through January 1978, the national unemployment rate's "on" trigger mandated extended benefits in all states, without regard to unemployment levels in individual states. These payments totaled about $6.6 billion, financed equally by Federal and state employer taxes (or in some cases by borrowing). It has been recommended to Congress that these benefits, retroactively, be repaid by general Federal revenues and not remain an obligation of future UI taxes.

One of the groups proposing this move was the National Commission on Unemployment Compensation. It based its recommendation solely on the timing of the extended benefits law, vis-a-vis the 1973-1975 recession. The Commission held that the severe recession had not been foreseen when the extended benefits program was designed in the late 1960s and enacted in 1970, and that the state provisions for financing the program had therefore not been designed so as to build up a fund adequate to meet the EB costs (4).

The Commission held that the same arguments apply with equal validity to liquidating Federal costs during the period when the national trigger was "on."

Two other notions could possibly lend support to such a move. 1) As previously noted, the national trigger at times proved insensitive to benefit needs in some states, mandating benefit payments in all states even when unemployment rates in some states were relatively low. 2) Federal extended benefits are not paid out of the experience-rated portion of employer taxes, and in many states extended benefits at the state level are not charged to the accounts of individual employers. (The latter observation, however, would not appear to support a one-time forgiveness of these debts.)

On the other hand, it can be argued that the states had had some previous experience with extended benefit programs, on a temporary basis, and that since 1970 this has been a permanent component of the UI program. If it is to remain so, it should be financed within the framework of the UI tax system. Moreover, the large majority of states were able to finance their extended benefits without undue drains on their financial resources. It could be argued, then, that Federal assumption of the EB costs would simply be another way of bailing out states that did not handle their finances prudently.

As of mid-1981, Congress had taken no action on the proposal. As noted elsewhere, however, recent legislation removed the national trigger, and modified the state triggers.

Easing Financial Pressure on the States - Cost Equalization

Various other proposals have emerged as to how to alleviate the burden of state debts built up largely during the 1973-1975 recession.

The proposals generating the most controversy appear to have been those advocating a new cost equalization program (5). By 1977, when 19 states had incurred $4.7 billion in debt

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4. Unemployment Compensation: Final Report, National Commission on Unemployment Compensation, Washington, D.C., 1980, p. 79.

5. This type of plan is also referred to as "reinsurance," and the terms are often used interchangeably. Technically the

to the Federal trust account, there was concern in some quarters about the ability of some states to repay their loans. In response to the situation, legislators from two of the states with especially heavy debt introduced cost equalization bills--legislation which would use Federal general revenues to bail out the insolvent states. Department of Labor estimates placed the cost of the bill introduced by Representative William Brodhead of Michigan (H.R. 8291) at $3.5 billion, and that introduced by Senator Jacob Javits of New York (S. 1853) at $6.6 billion. While these proposals were subsequently modified, and still others have since been presented, a brief review of the two measures provides an illustration of how such cost equalization schemes might work.

Generally, both bills specified that a state would be eligible for a Federal grant when its insured unemployment rate was 6 percent or higher, and annual benefit payments exceeded those in a "base year." Under the Brodhead measure, the base year was the most recent year in the past five in which the unemployment rate was lower than 6 percent; the Javits bill averaged the three lowest years in the past five. Under both bills, the Federal government would reimburse states for a percentage of the difference between benefit payments in the base year and a qualifying year, the percentage depending on the unemployment rate. The percent ranged from 25 percent to 50 percent in the Brodhead bill and from 50 percent to 75 percent in the Javits bill. Both would finance the grants from general revenues. The Brodhead bill would provide grants retroactive to 1974 and the Javits bill, only to 1975.

Table 15 gives the amounts which would have become available to individual states under the two bills. It will be noted that a substantial number of states would not benefit at all, but of course would share in the costs, since the program would be financed from general revenues. The percentage share of grants for a particular state generally differed by less than 1.5 percentage points under the two bills, with some interesting exceptions. The most notable is that under the Brodhead measure, Michigan would receive 17 percent of the total, compared

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two differ, mainly in the way a state would qualify for help. Under reinsurance, eligibility is measured against a state's own unemployment history; under cost equalization, against some nationwide norm. For a fuller discussion of the background, history, and pros and cons of these plans, see Joseph M. Becker, "Reinsurance and Cost Equalization," background paper for use by the National Commission on Unemployment Compensation, May 1978.

Table 15

GRANTS TO STATES UNDER TWO COST EQUALIZATION PROPOSALS
(Dollar Amounts in Millions)

State	H.R. 8291[a] Amount for 1974-1976	H.R. 8291[a] Percent of total	S. 1853[b] Amount for 1975 and 1976	S. 1853[b] Percent of total	Percent of total tax costs[c]
Alabama............	$ 47	1.3	$ 117	1.8	1.18
Alaska.............	32	.9	39	.6	.20
Arizona............	34	1.0	91	1.4	.95
Arkansas...........	29	.8	69	1.0	.65
California.........	325	9.2	823	12.5	10.73
Colorado...........	0	0	0	0	1.21
Connecticut........	114	3.2	194	3.0	1.97
Delaware...........	6	.2	19	.3	.35
District of Columbia..........	0	0	0	0	.43
Florida............	0	0	136	2.1	4.23
Georgia............	73	2.1	143	2.2	.45
Hawaii.............	3	.1	20	.3	.45
Idaho..............	0	0	7	.1	.30
Illinois...........	279	7.9	564	8.6	6.42
Indiana............	37	1.1	125	1.9	2.34
Iowa...............	0	0	0	0	.30
Kansas.............	0	0	0	0	1.05
Kentucky...........	29	.8	65	1.0	1.16
Louisiana..........	0	0	0	0	1.33
Maine..............	20	.6	37	.6	.40
Maryland...........	26	.7	56	.8	.25
Massachusetts......	176	5.0	239	3.6	3.01
Michigan...........	606	17.2	625	9.5	4.65
Minnesota..........	0	0	0	0	1.67
Mississippi........	10	.3	23	.4	.68
Missouri...........	49	1.4	102	1.6	2.03
Montana............	3	.1	16	.2	.29
Nebraska...........	0	0	0	0	.69
Nevada.............	8	.2	27	.4	.34
New Hampshire......	14	.4	23	.4	.37
New Jersey.........	323	9.2	332	5.0	4.25
New Mexico.........	2	.1	7	.1	.38
New York...........	354	10.0	740	11.2	10.09
North Carolina.....	120	3.4	196	3.0	1.99
North Dakota.......	0	0	0	0	.24
Ohio...............	0	0	245	3.7	5.22
Oklahoma...........	0	0	0	0	1.00
Oregon.............	40	1.1	102	1.6	1.03
Pennsylvania.......	391	11.1	809	12.3	5.48
Puerto Rico........	69	2.0	73	1.1	--
Rhode Island.......	41	1.2	54	.8	.44
South Carolina.....	59	1.7	101	1.5	.96
South Dakota.......	0	0	0	0	.23
Tennessee..........	63	1.8	113	1.7	1.57
Texas..............	0	0	0	0	5.27
Utah...............	0	0	0	0	.42
Vermont............	7	.2	17	.3	.18
Virginia...........	0	0	0	0	2.28
Washington.........	83	2.4	105	1.6	1.75
West Virginia......	8	.2	18	.3	.63
Wisconsin..........	38	1.1	87	1.3	2.02
Wyoming............	0	0	0	0	.17
Total...........	3,517	100.0	6,587	100.0	100.00

a. Introduced by Representative Brodhead (D-Mich.) in July 1977.
b. Introduced by Senator Javits (R-N.Y.) in July 1977.
c. This is the share of total Federal fund taxes each state would incur in financing the grant program in all states, as computed by the Tax Foundation for fiscal year 1976.

Source: U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service, Office of Research, Legislation and Program Policies, August 7, 1978; and Tax Foundation computations.

with 9.5 percent under the Javits proposal. New Jersey also would receive more and California, less, under the Brodhead bill. Two states, Florida and Ohio, would receive nothing under the Brodhead bill and substantial amounts under the Javits bill.

The final column of Table 15 shows how citizens in each state would have shared in the costs of any national grant program financed out of general revenues in 1976. This perspective also reveals some anomalies. For example, taxpayers in some low-income states, such as Mississippi and West Virginia, would pay considerably more in Federal fund taxes than they would receive back in cost equalization funds. Again, Texas taxpayers would pay 5.27 percent of the entire program costs, while receiving nothing in return under either plan. New Yorkers would be on the losing end under the Brodhead program, and would gain only slightly under the Javits measure. Altogether, under each of the programs some 30 states would be "exporting" part of their Federal tax payments to support unemployment grants to the remaining jurisdictions.

Since these two bills were introduced in 1977, other proposals have been put forth, with varying provisions as to when the grant program would be activated--i.e., what levels or change in levels of national and/or state unemployment would be required for a state to become eligible for funds; what measures of unemployment would be used as the trigger mechanism; how the grants would be financed, etc.

Those in favor of cost equalization contend that high unemployment lies beyond the control of any one state, and is analagous to natural disaster. Traditionally, Federal aid is rendered to areas struck with disaster, and unemployment disasters should be no exception.

A second point made by proponents of cost equalization is that the heavily indebted systems lie in danger of eventual collapse. The argument is that, faced with an enormously large debt, some of the states would regard the return to sound fiscal operation hopeless, and rather than taking the difficult steps required, would allow the situation to worsen until the Federal government is forced to make a far more costly rescue than would be required under a timely cost equalization scheme.

A third argument offered in favor of cost equalization is that it would enable states to maintain or improve benefit programs without resistance from employers, and without the need for large reserves. It is contended states would not abuse the availability of emergency help, because grants would be triggered only by the unemployment rate, over which (advocates say) the state has no control, and because the Federal help would never cover the entire cost of the program.

On the opposite side, critics hold that the existence of the loan program itself provides a type of reinsurance which has served very well up to now, and that no state's finances are in such serious condition that repayment could not readily be made over a reasonable length of time. Moreover, it is contended that labor's political power and the general attitudes of legislatures and voters have far more impact on liberalizing benefits than do costs per se.

A very important criticism is that cost equalization could be a major step in transforming unemployment insurance from an insurance system to a welfare program. This distinction is brought out in the following statement by Father Becker:

> While it is true that the people in Texas who wish to have the use of automobiles manufactured in Michigan should be ready to share in the cost of the unemployment benefits necessarily connected with the production of automobiles, it does not follow that the best way to achieve this sharing is by having the employers of Texas pay a subsidy to the employers of Michigan. The normal way is for the purchasers of automobiles to find the cost included in the price they have to pay for automobiles. This is the normal way of allowing the market to allocate resources (6).

Even among those who generally favor cost equalization, there are some who fear that any specified activator (e.g., a state uninsured employment rate of 6.0 percent) would be subject to relaxation at some future time, so that a grant program could take effect at times when the state programs should be entirely self-supporting.

In the course of public debate on the merits of cost equalization proposals in 1978, a significant amount of evidence was presented which indicated that the states in financial difficulty at that time were in large measure responsible for their own financing problems, because of a failure to build up their funds sufficiently to finance their benefit costs.

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6. Becker, op. cit., p. 16.

For example, William Papier, director of the division of research and statistics of the Ohio Bureau of Employment Services, commented as follows:

> This [is] the first time in four decades that so many state funds were insolvent. Was this due to an unusually severe recession? Or was it due to the failure of the states to build up their funds sufficiently to finance their benefit costs? (7)

Papier assembled data comparing the recession of 1958 with that of 1975. In the years preceding the 1958 recession, he noted, states built up their reserve funds, as was intended when the UI system was set up, so that the average reserve was 5.0 percent of total covered payroll at the end of 1957. In contrast, states depleted reserves during the "better years" prior to the 1975 recession, and the average reserve ratio had dropped to 1.9 percent.

Table 16 indicates that the heavily indebted states were especially culpable. On December 31, 1974, 15 of the 17 had reserve ratios below--some substantially below--the already low national average. Arkansas, with only a small debt in 1978, had a reserve ratio the same as the U.S. average. New York's reserve ratio was 0.4 percentage points above the average--and New York was the last of this group to resort to borrowing.

In a statement before the National Commission on Unemployment Compensation in 1978, representatives of the Council of State Chambers of Commerce presented additional evidence that many of the states in debt had contributed significantly to their own financial problems (8). For example:

1. Nineteen of the 20 states in debt at that time had reserves below what is considered normal for determining fund adequacy (1½ times their highest 12-month benefit cost since 1958).

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7. Research Memo No. 206, July 11, 1978, p. 1, Division of Research and Statistics, Ohio Bureau of Employment Services.

8. Statement of Edward H. Kay and John Dankowsky on behalf of Social Legislation Committee, Council of State Chambers of Commerce, to National Commission on Unemployment Compensation, June 27, 1978.

Table 16

1974 YEAR-END RESERVE RATIO OF STATES WITH INDEBTEDNESS TO FEDERAL UNEMPLOYMENT ACCOUNT AS OF JULY 1978[a]

State	Reserve ratio
U.S. average	1.9
Pennsylvania	1.6
Illinois	1.4
New Jersey	0.2
Michigan	1.4
Connecticut	0.1
New York	2.3
Massachusetts	0.9
Minnesota	0.8
Washington	0.1
Rhode Island	0.6
Delaware	1.8
Vermont	0.1
Alabama	1.7
Maine	1.5
Arkansas	1.9
Hawaii	0.8
Montana	1.6

a. States listed in order of size of indebtedness as of July 31, 1978. Reserve as of December 31, 1974 as percent of total covered payroll.

Source: Adapted from Research Memo No. 206, Division of Research and Statistics, Ohio Bureau of Employment Services, July 11, 1978.

2. In six of the debtor states, the five-year average insured unemployment rate was lower than the national average of 4.3 percent; the business recession, therefore, could not have been the sole reason those states borrowed.

3. Ten of the 20 states had an average employer tax rate (to total wages) at or below the national average tax rate for 1976 and 1977. This in turn contributed to their financial problems.

4. Fifteen of the 20 states had a ratio of insured unemployment to total unemployment that was above the national average for 1973-1977. (At least in part, an above-average ratio reflects a liberal UI program; the states desiring such provisions, the Council pointed out, should either have provided adequate financing or eliminated certain liberal provisions.)

5. Other evidence that some of the debtor state programs were more liberal than average was cited by the Council. For example, the debtor states included 8 of the 10 states which provide for uniform duration of benefits (rather than variable in accordance with length of service or wage credits), 9 of the 12 states which allow additional benefits for dependents of jobless workers, and 7 of the 12 jurisdictions which require no waiting week for the receipt of benefits.

Revising Federal Loan Provisions

The practice of granting interest-free loans to states whose UI reserves are depleted, as well as some of the provisions for repayment, has come under criticism on a number of grounds. As noted above, in the latter part of the 1970s, Congress suspended the existing rules concerning payment on several occasions, enabling states to defer repayment without incurring an additional penalty tax until 1981.

The availability of the loans, especially on an interest-free basis, is said to discourage borrowing states from attempting to restore solvency by taking the unpopular steps of either raising employer taxes or constraining benefits. The loans, it is held, rewarded debtor states for imprudent handling of their UI finances at the expense of employers in non-debtor states. The subsidies became even more valuable with the postponement of repayments, since loans were repayable over longer and longer periods in devalued dollars. At the same time, many observers felt that the additional penalty tax for nonpayment, which was re-instated in 1980, was too severe, particularly since the higher tax rates would be mandated during a period when another economic recession was under way.

Congress addressed these problems by enacting important changes in the loan provisions as part of the Omnibus Budget Reconciliation Act of 1981. Generally, the loans will no longer be interest-free, and there will be a limit on the tax penalty for nonpayment on time for states who meet prescribed solvency standards.

Interest will be charged on the loans received between April 1, 1982 and December 31, 1987, generally at the same rate as that paid by the Federal government on balances in state UI trust funds during a specified period, but no higher than 10 percent annually.

For the period October 1, 1981 through December 31, 1987, the states that meet certain solvency requirements will be entitled to a 0.6 percent limit on the Federal tax credit reduction (i.e., tax penalty) resulting from outstanding Federal loans. To qualify for the limitation for tax years 1981 and 1982, a state would be required to meet specific conditions regarding its unemployment tax effort and the solvency of its UI system. (Both tax effort and solvency are to be defined by the Secretary of Labor in regulations.)

To qualify for the tax credit reduction limit in years after 1982, a state would not only have to meet the tax effort and solvency tests, but two others as well. To get the minimum reduction, a state will have to show that its average unemployment tax rate for the year in question is at least as high as the average of the benefit-cost ratio in that state for the last five calendar years (9). In addition, the state's loan balance could not exceed its level in a previous period, generally three years earlier.

Proposals for Reducing Federal UI Costs

By 1979 some members of Congress had become concerned about the adverse effects of the unemployment insurance system on the Federal budget. Motivated by a desire to control these costs, the Subcommittee on Unemployment and Related Problems of the Senate Finance Committee held hearings in October 1979. The cost-cutting proposals included suggestions affecting provisions for regular (state-financed) benefits as well as those for Federal-state extended benefits.

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9. Benefit-cost ratio is defined as the ratio of benefit expenditures to total wages in employment subject to UI taxes.

While many of those testifying before the panel indicated support in principle for the proposals, the major objections were of two kinds: 1) the enactment of many of the measures would serve further to "Federalize" the UI system, limiting the prerogatives of the states to fashion their own programs in accordance with local economic and political factors; and 2) Congress should not act on any of the measures until it received the recommendations of the National Commission on Unemployment Compensation.

Still another objection to the package of measures seems somewhat obvious. While there appears broad public support for recent moves by Congress to restrain the growth in Federal spending and limit the size of the deficit, serious questions can be raised as to whether the state-financed portion of the unemployment compensation program should be subject to manipulation in order to achieve the overall budget objectives, however meritorious the latter may be. It is in the nature of an accident of history that UI finances are an integral part of the unified Federal budget, introduced in 1969. Most of the UI receipts and outlays in the budget are attributable to state taxes and state benefit payments. Why should the U.S. Congress have (more) budgetary control over these state funds? While this particular criticism would not relate to Federal finances, a question can be raised as to the efficacy of trimming costs of a countercyclical program at a time when its benefits are presumably most needed.

Other Recent Congressional Action

Congressional consideration of elements in the UI system has continued to relate to efforts to restrain the overall growth of Federal spending. In both 1980 and 1981 the revisions were aimed at reducing the Federal government's costs under the program and did not touch aspects of the program which traditionally have been subject to state determination. Some of the resulting legislation has already been discussed. As indicated in Section V, the "trigger" provisions activating an extended benefits program were revised by both eliminating the national trigger and raising the unemployment rate at which an individual state's trigger will go "on." As discussed above in this section, important changes were enacted concerning Federal loans to the states; interest will henceforth be charged on the loans, and the states must maintain prescribed solvency standards to avoid larger tax penalties for nonpayment.

The Omnibus Budget Reconciliation Act of 1980 tightened the rules under which the Federal government will participate in funding extended benefits (10). Under the 1980 law, the Federal government will no longer pay a share of the cost of extended benefits in states without a waiting week for regular benefits, or in states with a waiting week for which benefits are paid retroactively. The law also tightened eligibility requirements for extended benefits. They will be denied to individuals who fail to meet certain requirements related to work--e.g., those who are disqualified from receiving state benefits because they voluntarily leave work, are discharged for misconduct, or refuse suitable employment (11); those who fail to accept (or apply for) certain prescribed types of work; and those who fail to provide tangible evidence of a systematic and sustained effort to find work.

The revisions, previously reported, concerning loan provisions and trigger rates for activating extended benefits were introduced in the Omnibus Budget Reconcilation Act of 1981. The same law also contained two other significant provisions affecting the extended benefits program, including 1) changing the formula for calculating extended benefits and 2) increasing the work/wage requirement for receiving extended benefits (12).

1) Previously the formula for calculating the extended benefits trigger involved dividing the number of individuals filing claims for both regular and extended benefits by covered employment in a specified base period. The 1981 law excluded extended benefit claimants from the computation of the state insured unemployment rate for purposes of the trigger. The change has several implications. It will tend to lower a state's computed insured unemployment rate and thus delay or shorten the period when the trigger is "on" for the additional

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10. Other provisions not affecting state financing included termination of special funding for unemployment compensation for former CETA workers, and an increase in the period of active duty an individual must serve in the military for unemployment compensation purposes.

11. The law stipulates that the work be within the person's capabilities, pay the minimum wage, pay a gross weekly wage that exceeds any UI benefits payable to the individual, and be otherwise consistent with the state definition of "suitable work."

12. Other portions of the law dealt with special unemployment programs for ex-servicemembers and for those receiving Trade Adjustment Act benefits.

13 weeks of extended benefits. On the other hand, the change could avoid a delay in activating extended benefits when unemployment rises; this could happen previously if people were receiving extended benefits in the previous years' comparisons, because of the requirement that an EB program could not be activated unless the insured unemployment rate was 20 percent higher than in the previous two years.

2) The law also imposed additional work/wage requirements for extended benefits eligibility. In the future, applicants must demonstrate a stronger attachment to the labor force in order to qualify for extended benefits. At least 20 weeks of work in the base period, or an equivalent amount of wages, will be required to qualify.

VII.

SUMMARY AND CONCLUSIONS

Sweeping changes, especially during the 1970s, have transformed the U.S. unemployment insurance system into an entity radically different from the system which many considered so revolutionary when it was introduced some 46 years ago.

Like other institutions, the unemployment compensation program has changed with the times, generally--at least until quite recently--in a direction of increasing liberalization. Federal laws have expanded mandatory coverage to include virtually all salaried workers and have offered lengthened benefit periods. State laws affecting aspects of the program subject to state determination have been revised frequently, both in response to changes in Federal law and to changing economic and political circumstances.

While no program of such broad scope, and with so many ramifications, is without flaws--and critics--the record of the U.S. unemployment insurance system throughout most of its existence has generally been salutary. Millions of jobless workers have received temporary financial assistance to tide them over periods of unemployment while searching for other work. Employers finance the program through payroll taxes, and the unemployed worker can view the benefits received as something he has earned, rather than as a matter of welfare.

Despite its long-term history of effectiveness, the system during the 1970s at times seemed to be teetering on the brink of bankruptcy. In some respects it was hostage to its previous generosity. Both the Federal government and many states found it necessary to borrow to meet their UI commitments because they had failed to anticipate the financial claims the program would generate and to set aside sufficient funds in advance. A few examples illustrate the problem:

--Benefits paid under the regular state programs--financed entirely by state taxes on employers--tripled during the 1973-1975 recession, from $3.8 billion in 1970 to a record high of $11.8 billion in 1975.

--Regular benefits paid in 1975 covered more than 175 million weeks of unemployment, also an all-time high.

--Extended and supplemental benefit programs added about 30 percent to the costs of the regular program during the deepest years of the recession.

--During the 1970s more than two dozen states received interest-free loans from the Federal trust fund, totaling over $6 billion; by early 1980, $4.2 billion of this was still outstanding in 15 states.

--The Federal unemployment fund was in debt to the Treasury for $5.8 billion borrowed to finance the supplemental benefits program, and for a portion of its share of extended benefits.

This sudden upsurge in financial barometers reflects several factors. During the past decade, Federal legislation provided for ever-increasing amounts of special benefits in times of high unemployment. In 1970, an extended benefits program was established on a permanent basis; those exhausting the regular benefits under state programs, generally lasting 26 weeks, became eligible for a 13-week extension, half of which would be supported from the Federal share of the UI tax. Congress also enacted several laws granting a third tier of benefits in periods of especially heavy unemployment. At one time these Federal supplemental benefits, together with regular and extended benefits, lengthened the period during which eligible unemployed persons could receive full benefits to 65 weeks.

More or less concurrently with the Congressional mandate for more generous duration of benefits, the country began to experience the deepest economic recession in the history of the unemployment program. At the same time, it became evident that a number of states, particularly those offering the most generous programs, had failed to shore up financing provisions by raising taxes. Thus financial reserves at the outset of the 1973-1975 recession were far below the amounts considered adequate as a normal safety valve. The ready availability of interest-free loans from the Federal government no doubt contributed to the states' reticence to buttress their own UI resources.

Yet another factor in the sharp rise in unemployment benefit costs was the substantial expansion in coverage. Approximately 9 million employees, an increase of 17 percent, were added to the rolls just between 1970 and 1976. (Several million additional workers have been added since, under provisions of a 1976 Federal law.)

At no time in its history had the UI system been put to such a severe test. At about the same time the system began to come under increasing criticism for its alleged effect in encouraging unemployment through its disincentive effect on both employers and workers.

Meanwhile, there was a simultaneous mushrooming of other Federal programs providing employment aid to persons experiencing various kinds of financial distress. Federal budget outlays for "employment and training" shot up from under $2 billion in 1970 to more than $6 billion in 1976 (and to more than $10 billion annually in later years). A baffling array of Federal programs had sprung up, all with the objective of either increasing the work skills and job opportunities of persons already in the work force and persons who faced almost insurmountable barriers, because of lack of vocational training or other problems, in their attempts to find jobs. Perhaps the best known was the Comprehensive Employment and Training Act (CETA), which provided public service jobs, youth programs, welfare reform demonstrations, and an initiative for private sector jobs.

Parallel with the increased outlays for programs designed to help individuals earn their own way, programs for outright welfare in the form of public assistance and other income supplements (generally on a needs-tested basis) also increased markedly.

These developments, together with other considerations, were influential in leading Congress to seek a clearer definition of the role of unemployment insurance in the overall income security system. In 1976 Congress provided for the establishment of a National Commission on Unemployment Compensation. After some delay in getting under way, the Commission submitted its final report in December 1980. The recommendations include about 150 separate provisions; some were addressed to state legislatures; some were addressed to Federal and state administrators of the UI program; and others to the Congress and the President. While any major discussion of the report falls outside the scope of this study, several salient points merit attention here. If accepted, the suggestions of the panel would require many of the states to liberalize various provisions of their programs--including the payment of higher average benefits, would raise employer taxes, and--a criterion that most employer associations and state administrators sharply oppose--impose additional Federal standards on benefit amounts and other facets of the program. The actual costs of the changes would depend upon future unemployment levels, and available estimates are not definitive; however, there is no doubt that the recommendations, if approved, would add billions of dollars annually to the costs of the UI program, which is supported by employer taxes.

Apropos of the last point, it seems pertinent to add that unemployment taxes currently add almost 25 percent to employer bills for taxes associated with employment, i.e., social security and related taxes. From 1970 to 1980, employment-related taxes paid by employers grew from $23 billion to $85 billion, an increase of 271 percent, compared to a rise in total Federal budget receipts of 175 percent.

In the interim between the appointment of the Commission and the publication of its final report, Congress considered a variety of proposals, many of them related to the existing financial problems within the system. These included suggestions concerning the retroactive funding of portions of the extended benefits program and the Federal supplemental benefits program; ways to ease pressures on states resulting from the build-up of debt--such as setting up a cost equalization program to even out employer costs among states through a new Federal grant-in-aid system; revising provisions concerning the interest-free loans to states; and introducing new economies in the overall system in order to ameliorate its effects on the Federal budget deficit. It was not until the early 1980s, however, as noted below, that Congress acted on some of these issues.

Two measures of note, however, were enacted during the latter part of the 1970s, signaling shifts in Congressional thinking on some UI provisions. Seemingly in response to critics who questioned the alleged "over-generosity" of the program, particularly with the addition of significantly longer periods of benefits, Congress in 1978 voted to impose income taxes on a portion of unemployment benefits for those in families with income above certain levels. In enacting another Federal supplemental benefits program in 1978, Congress approved general-revenue financing for the program, thus shifting these costs to taxpayers at large. This decision apparently implied that Congress believed that unemployment beyond the first 39 weeks of benefits should no longer be considered a responsibility of the employer, and that employer-paid taxes should not be tapped to pay for these benefits. In the same measure, Congress included provisions which tighten up eligibility for longer-term benefits. Congress did not, however, set up a separate program for the long-term unemployed, which would be administered outside of the UI program, as some have suggested; nor did it establish a supplemental benefits program on a permanent basis.

By the beginning of the 1980s, it had become clear that a major concern of the Congress about the UI system was related to its effect on Federal finances. Significant cost-cutting measures were included in the omnibus budget reconciliation bills in both 1980 and 1981.

Congressional action in 1980 tightened the rules under which the Federal government will participate in financing extended benefits, and in effect required the states to adhere to the same provisions. Henceforth, all states will be required to withhold regular benefits for a one-week "waiting period," and claimants must meet more stringent work and work search requirements in order to qualify for extended benefits. Other provisions of the law included cutbacks in special programs financed entirely by Federal general revenues (e.g., programs for former CETA workers, and military personnel).

Other significant changes were introduced in the Omnibus Budget Reconciliation Act of 1981. Among them were: states may no longer receive interest-free loans from the Federal unemployment trust fund, and provisions for eligibility and repayment of such loans will be different; there will no longer be a national "trigger" rate of insured unemployment which will mandate extended benefits in every state, without regard to unemployment in individual states; and in the future claimants for extended benefits must demonstrate a more stringent work/wage employment history in order to qualify for benefits.

While no full record of the changes is available, it is clear that many states have tightened up on some benefit provisions such as those regarding eligibility, attachment to the work force, disqualification rules, and others. Moreover, many states have raised employer taxes. Reflecting such changes, and the economic expansion of the late 1970s, the unemployment insurance system by 1979 was collecting almost $16 billion in taxes (as compared with less than $7 billion in 1973), or almost $7 billion more than the amount paid in benefits.

Concluding Remarks

Much of the public attention the UI system has received in recent years relates to problems that came to the fore in the 1970s. Any UI system faces its major test during periods of deep and prolonged recession. Fortunately, the 1980 recession was short, lasting only from January through July.

In good times or bad, controversial issues in the unemployment system are likely to recur, since there is no assurance that hard and fast rules have been established to date. These issues include:

--How long should benefits offered under the state unemployment program continue? Should jobless workers be required to take jobs below the level they previously held if their unemployment lasts, say, longer than 13 weeks? Should the program, including extended benefits, be limited to 39 weeks?

--Should a separate program be established for the longer-term unemployed (beyond 39 weeks)? Should it be based on a test of need? Should it fall outside the administration of the UI system at large?

--Should the Federal government set up a reinsurance or cost equalization program to even out the costs of unemployment among low-cost and high-cost states? If so, should it be financed from general Federal revenues or through added employer taxes in all states?

--How can the experience rating system be improved? What can be done to modify the present system under which a significant share of costs is not charged to the experience of a single employer, but becomes socialized (i.e., shared by all employers, regardless of their employment experience)?

--Should unemployment benefits continue to be taxed as income to higher income recipients, as approved by Congress in 1978? Will the taxability of benefits itself tend to raise the (before-tax) benefit levels?

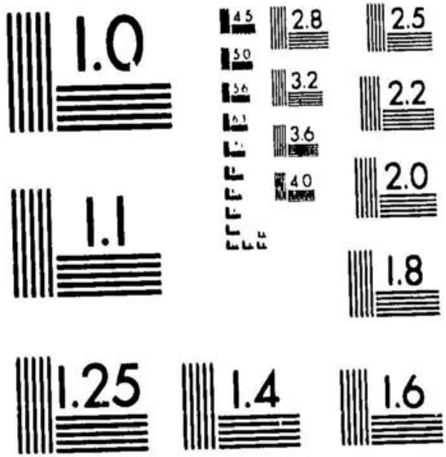
--How might the system be better safeguarded against abuses by those not rightfully entitled to benefits?

--Are funds now available for Federal and state aspects of administering the program adequate, in view of the heavy demands on the system?

--Should the taxable base of the payroll be automatically adjusted (indexed) for rising wages or prices?

--Should the Federal government impose restrictions which would standardize benefit levels in the individual states?

To a significant degree, the "answers" to these and other questions about the system will depend upon the broad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philosophical framework in which policy-makers see the unemployment system operation. The basic question, either directly or implicitly, becomes: What is the legitimate function of an unemployment program in our society? How much can--and should--it do?

Underlying these questions are yet two other broad considerations. When does unemployment shift from an insurance matter to a social welfare matter? Are the states to retain a significant role in making their own decisions about program provisions, within broad Federal guidelines, or is the program to be subject to more domination by the Federal government?

There are clear indications that the system, especially in recent years, has been saddled with responsibilities far beyond those implied by a social "insurance" program. Yet the linchpin of the system, adopted in 1935, was that unemployment for millions of steady workers is indeed an insurable risk, at least for a specified temporary period. Moreover, variations among states in political, social, and economic conditions were recognized as factors that should give the states wide latitude in determining important provisions of their individual programs.

The Federal government enlarged its role in influencing the UI system during the 1970s, especially in approving lengthened benefit periods, with which the states had no choice but to go along. Congress has now pulled back on some of the liberalizations, in part upon recommendations of the new Administration. But the inclusion of state unemployment receipts and benefits payments as an integral part of the Federal budget will continue to keep the UI program under close scrutiny of Federal budget-makers.

Changes in the system since the somewhat harrowing financial problems of the mid-1970s appear to have ameliorated these problems somewhat. It is to be hoped that the lessons learned by state and Federal policy-makers during that period will enhance their ability to keep the UI system operating on a firmer financial basis in the remainder of the 1980s and beyond.