ADVISORY COUNCIL ON UNEMPLOYMENT COMPENSATION:

BACKGROUND PAPERS

VOLUME I
JULY 1995

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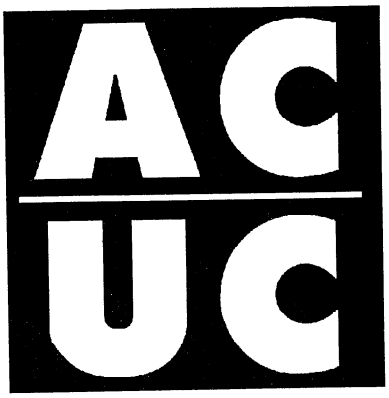

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PREFACE

In November 1991, the Congress of the United States passed the Emergency Unemployment Compensation Act (P.L. 102-164). The act included a section that created the Advisory Council on Unemployment Compensation, which was charged with the task of evaluating "the unemployment compensation program, including the purpose, goals, countercyclical effectiveness, coverage, benefit adequacy, trust fund solvency, funding of State administrative costs, administrative efficiency, and any other aspects of the program and to make recommendations for improvement."

The Advisory Council is made up of eleven members who represent the interests of business, labor, state governments, and the public. Five of the members are appointed by the President, three members are appointed by the Senate, and three members are appointed by the House of Representatives.

The Advisory Council has generally approached its work by focusing its attention on broad, fundamental elements of the Unemployment Insurance system. During 1993, its first year of operation, the Council examined the need for reform in the Extended Benefits component of the Unemployment Insurance system. Its work during the second year focused primarily on those issues related to benefits, eligibility, financing, and coverage. During its third and final year of operation, the Council is considering issues generally related to program administration, including appeals and federal-state responsibilities, as well as issues such as nonmonetary eligibility and program data.

In carrying out its mandate to evaluate and analyze the Unemployment Insurance system, the Advisory Council has relied on a diverse collection of information sources. The Council receives regular briefing materials from its staff and has also held a series of public hearings across the country in order to allow interested individuals and organizations to present their views to the Council. In addition, the Council has planned a number of academic conferences to facilitate the exchange of ideas and the presentation of works of research on Unemployment Insurance. These forums include two economics research conferences, one held in August 1994, and another in August 1995, and a legal symposium, sponsored jointly with the University of Michigan Journal of Law Reform in March 1995.

These two volumes and two volumes published in July 1995 contain most of the research that has been undertaken on behalf of the Council, both by the Council's staff and outside researchers. The papers presented at the legal symposium will be published separately by the University of Michigan Journal of Law Reform later this year.

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NONMONETARY ELIGIBILITY: STATE VARIATIONS AND EFFECTS

Amy B. Chasanov
June 1995

Amy B. Chasanov is a policy analyst at the Advisory Council on Unemployment Compensation. The views expressed in this paper are those of the author and do not necessarily reflect those of the members of the Advisory Council on Unemployment Compensation. This is a preliminary draft and should not be quoted without the permission of the author.

NONMONETARY ELIGIBILITY: STATE VARIATIONS AND EFFECTS

INTRODUCTION

There are two broad categories of eligibility standards—monetary and nonmonetary—that are applied in determining whether an unemployed individual is eligible for Unemployment Insurance (UI) benefits. Collectively, monetary eligibility conditions are designed to ensure that those who receive UI benefits had a substantial attachment to the labor force prior to unemployment.[1] Nonmonetary eligibility requirements are designed to limit payment of benefits to only those workers who are unemployed primarily due to economic causes. Both types of eligibility requirements are determined by the states, with only minimal requirements imposed by the federal government.[2] As a result, there is considerable variation across states in these requirements.

Monetary Eligibility

Most states have a number of monetary eligibility requirements. Although specific levels vary, all states require that workers earn a specified amount of wages and/or work a certain amount of time within a "base period" in order to be monetarily eligible for benefits.[3] Most states also require a minimum amount of earnings in the high-wage quarter (that is, the calendar quarter in the base period in which the highest level of wages were earned), and that wages be earned in at least two of the four calendar quarters in the base period. Some states have additional monetary qualifying requirements.

Nonmonetary Eligibility

In addition to meeting states' monetary eligibility conditions, applicants for Unemployment Insurance benefits must also meet a number of nonmonetary eligibility conditions. These nonmonetary eligibility conditions are designed to ensure that UI recipients (1) are either involuntarily unemployed or voluntarily unemployed for good cause, and (2) are able to work, available for work, and seeking work.

Although particular nonmonetary eligibility conditions vary considerably by state, the general categories are similar. States ***initially*** disqualify individuals from receiving benefits for

a number of reasons, including the following: (1) voluntary separation from work without "good cause," (2) discharge from employment due to misconduct related to the job, (3) unemployment resulting from a labor dispute, and (4) fraudulent misrepresentation to obtain or increase benefits. These are termed "separation issues" because they relate to the individual's separation from employment. These disqualifications usually result in a postponement of benefits for the duration of the unemployment spell or for a specified period of time. In many states, an individual who is disqualified for one of these reasons must work for a given amount of time before he or she can requalify for UI benefits. The specific penalties associated with these disqualifications are specified in each state's law.

In addition, there are three categories that are termed "nonseparation issues" because they do not relate to an individual's initial separation from employment, but instead to an individual's ***ongoing*** eligibility for UI. First, a UI claimant must be able to work and be available for suitable work in order to be eligible to receive benefits. Second, a claimant must be looking for work and must submit evidence of a job search in accordance with state law. These two conditions are generally considered continuing requirements—that is, requirements that must be met each week. If an individual is disqualified for not meeting one of these two continuing requirements, he or she may receive benefits again as soon as that condition changes. Third, an individual is disqualified from receiving UI benefits if he or she refuses an offer of suitable work without "good cause;" this is viewed as a more serious situation and results in a postponement of benefits for the period of time specified in state law.

While the general categories of nonmonetary eligibility conditions and their associated penalties are usually stated directly in state law, the law is frequently quite general and lacks specific definitions of these categories. The specific interpretations of eligibility conditions often appear in state rules, regulations, or administrative or judicial case law. At times, these available sources may conflict. As a result, predicting the treatment of a given individual or circumstance, even within a particular state, can be extremely difficult.

The Interstate Conference of Employment Security Agencies (ICESA)[4] recently conducted a survey of the states, which provides much more complete, current information than was previously available regarding nonmonetary eligibility conditions. The purpose of the survey was to provide clarifying information on exactly how individuals would be treated in a variety of

situations across all states. During October and November 1994, the survey was mailed to all 50 states, as well as in the District of Columbia, Puerto Rico, and the Virgin Islands. All 53 states responded to the survey. UI directors in each state were asked to respond to the survey based on their *expected agency result* (that is, the directives given to claims examiners on how to make nonmonetary eligibility decisions). The survey focused on a number of specific nonmonetary determination situations, including the following: part-time work, restriction of work hours, classification of temporary workers, student status, mental or physical conditions that limit work, and domestic obligations.

This paper discusses the different categories of nonmonetary eligibility, how these issues are detected, and their associated penalties. It reviews the states' responses to the ICESA survey and notes when this survey information varies significantly from information readily available in state laws. The paper also presents the conclusions from a separate survey of claims examiners in five states which was designed to determine whether there are significant variations in the nonmonetary determinations *within* states.[5] In addition, the results from the ICESA survey are compared with a legal review of state law, regulation, and case law for one eligibility issue. The paper concludes with a summary of the policy implications suggested by the nonmonetary survey results.

STEPS LEADING TO A DETERMINATION OF NONMONETARY INELIGIBILITY

Determining ***monetary*** eligibility is a straightforward process that is based solely on the employment and earnings history of the UI applicant. In contrast, determining ***nonmonetary*** eligibility is frequently a more difficult process. There are three steps that can ultimately lead to a denial of benefits on the basis of nonmonetary eligibility. First, the state agency must define and impose a set of nonmonetary eligibility requirements. Second, the state identifies potential nonmonetary eligibility determinations issues in individual cases. Third, the state assembles information from the employer and claimant, considers the facts of the case, and makes a determination to either deny or grant UI benefits.

While most of this paper deals with one aspect of the first step—defining the current nonmonetary eligibility requirements across states—it is the process of identifying and evaluating individual cases that ultimately leads to actual nonmonetary denials. Thus, the definitions

presented in this paper represent the laws, regulations, and interpretations that are applied in determining whether an individual claimant will be denied or awarded UI benefits. The impact of the various conditions that ultimately lead to ineligibility is determined most directly by the extent to which nonmonetary eligibility violations in specific cases are actually discovered. Just as the definitions of nonmonetary eligibility vary significantly by state, there is also variation across states in the processes used for detecting determination issues (i.e., the observation of a reason to question an initial separation issue or a claimant's continuing availability for work).

Determination Rates

While a thorough description of how each state currently detects and decides separation and nonseparation issues is not available, some general information is known. The number of determinations for *separation* issues depends primarily on (1) the intake process and (2) the information obtained from employers.[6]

With regard to the intake process, the nature of the procedures that are followed may have a number of different effects, including causing an increased number of determinations. (In addition, the nature of the intake process may result in misinformation being provided during intake or discourage individuals from applying for benefits.) Variations in the intake procedures that could affect the number of determinations include the following: when information on nonmonetary eligibility requirements is provided to claimants (i.e., before or after the intake process), whether additional forms are required at intake if a separation issue arises, and how questions are posed to claimants (e.g., a submission of fact or a claimant's judgement call on the matter of whether the separation action was with "good cause").

With regard to the information obtained from employers, the procedures in place to solicit employer information significantly affect the level and type of employer participation. Variations in the processes for obtaining employer information include the following: when and how information is gathered from employers (e.g., is a form automatically sent out with every application for UI benefits, or does all responsibility for contesting a claim originate with the employer), how the questions are posed to employers, and whether follow-up measures are taken to ensure a response.

The number of determinations for *nonseparation* issues detection depends largely on four types of information: (1) the intake form; (2) ongoing claims forms, which include information on claimants' job search; (3) Eligibility Review Program (ERP) interviews; and (4) claimants' responses to referrals and job offers generated by the Employment Service. States vary on how often ongoing claims forms are submitted, as well as how they interpret and review information submitted on forms. For example, states that randomly audit some portion of employer contacts on required job search activity or that review the claims forms in detail are more likely to detect an issue than states which have no review procedures. Similarly, in some states, missing one appointment with UI staff (e.g., ERP interview) is considered to be evidence of unavailability for work, whereas other states are concerned only with repeated broken appointments, and still other states never consider this to be a reason to initiate a determination. The frequency with which interviews and claims forms are required is another dimension of interstate differences that affects how well nonseparation issues are detected.

Given this wide range of state variability in issue detection, it is to be expected that determination rates vary significantly by state. In 1994, approximately 18 percent of all initial UI claims result in a *separation* determination; approximately half of these are for voluntary leaving and the other half are for misconduct. This ratio has fluctuated historically, but has been increasing since its low of 11 percent in 1982. By state, the 1994 ratio of separation determinations to initial claims ranged from a low of 9.5 percent in Alabama to a high of 79.1 percent in Nebraska. As mentioned earlier, significant differences in determination rates are likely to arise due to different detection procedures, as well as varying definitions of what constitutes a determination.

The total number of nonseparation determinations is slightly lower than the number of separation determinations. Because claimants may become ineligible at any time while receiving UI, nonseparation issues are expressed as a percent of weekly claimant contacts. In 1994, about 2 percent of all claimant contacts result in a *nonseparation* determination. In 1994, 38 percent of these were due to "able and available" issues, 25 percent were due to claimants' earning potentially disqualifying income, 21 percent were due to reporting requirements, and 5 percent were due to refusal of suitable work.[7] By state, the 1994 ratio of nonseparation determinations

to claimant contacts ranged from a low of 0.2 percent in Tennessee to a high of 8.5 percent in Utah.

Research indicates that the capacity of states to make the decision to deny benefits to UI claimants on the basis of nonmonetary ineligibility depends more on the effectiveness of detecting determination issues than on the actual extent to which determinations lead to denials (Corson et al. 1986). Stated somewhat differently, there is more fluctuation across states in determinations per initial claim than in the ratio of denials to determinations, which is more steady. In general, the number of denials in a state is more dependent on the number of determinations in the state than it is on the specific relationship between determinations and denials.

DISQUALIFICATION PENALTIES

Claimants can be disqualified from receiving UI benefits as a result of all separation issues discussed above. Claimants can also be disqualified from receiving benefits for refusing suitable work, which is a nonseparation issue. Claimants who are determined to be unable or unavailable for work may be temporarily ineligible for benefits in a given week, but they are not disqualified and can again receive UI as soon as their condition changes.

Disqualifications may result in a postponement of benefits either for a specified period of time or for the duration of the spell of unemployment. All state laws specify some length of time for each type of disqualification. When states set the disqualification to be less than the duration of the unemployment spell, it reflects a view that a worker's continued unemployment after a specified period of time is more a result of general labor market conditions than of the individual's disqualifying act. In some states, the number of weeks of disqualification varies in relation to the seriousness of the disqualifying action.

When a disqualification results in the denial of benefits for the duration of the unemployment spell, a disqualified individual usually must work for a given additional amount of time before requalifying for UI benefits. The amount of time that an individual must work varies significantly both by state and by the reason for disqualification. For example, an individual in Kansas who is disqualified from receiving benefits for the duration of an unemployment spell for leaving voluntarily without good cause must then earn 3 times the weekly

benefit amount (that would have been collected) before requalifying; a similar individual in Idaho must earn 16 times the weekly benefit amount before requalifying.

In addition to being disqualified from receiving benefits for a certain period of time, an individual may also have UI benefit payments reduced when the disqualification period ends and/or have benefit rights cancelled. A cancellation of benefit rights, which may occur for incidences of "gross misconduct" or fraud, erases all of an individual's recent employment history for purposes of current and future benefit determination.

The actual severity of the impact of any given penalty to an individual, however, depends ultimately on the individual's duration of unemployment. For example, disqualification for the duration of unemployment is a small penalty for an individual who becomes reemployed within a few weeks, but it is much more severe for someone who is unemployed for many months.

Table 1 shows the severity of the disqualifications across states in 1994 for four major UI eligibility violations—voluntary leaving without good cause; discharge for deliberate misconduct connected with work; discharge for gross misconduct connected with work; and refusal of suitable work without good cause. Over time, states have significantly increased their use of disqualifications for the *duration of unemployment*. Table 2 illustrates the increase in the severity of the penalties for these disqualifications.[8]

SEPARATION ISSUES CAUSING DISQUALIFICATION

States *disqualify* individuals from receiving benefits for a number of reasons related to job separation, including the following: (1) voluntary separation from work without "good cause," (2) discharge from employment due to misconduct related to the job, (3) unemployment as a result of a labor dispute, or (4) fraudulent misrepresentation to obtain or increase UI benefits. The survey addressed specific disqualifications resulting from voluntary separations and misconduct.[9] This section focuses on these two primary types of separation disqualifications, and highlights the differences between state laws and actual state practices, as indicated by the ICESA survey.

Voluntarily Leaving Without Good Cause

The UI system is intended to compensate workers who are unemployed through no fault of their own. As a result, individuals who voluntarily leave their job without "good cause" are disqualified from benefits. There are two main questions connected with this type of disqualification: How is a quit defined? How is good cause defined? There are a number of situations in which defining a quit is difficult. For example, when a temporary employee refuses to take a subsequent temporary job offer, when an individual holds multiple jobs and may be fired from one and quit the other, or when an employer considers the separation a "quit" but the employee considers himself "fired" (e.g., a unilateral change in the job that the employee cannot accommodate).

This section focuses on the definition of good cause--under what conditions an employee can leave a job and still be eligible for UI benefits. Currently, if an individual is found to have voluntarily quit a job without good cause, all but five states currently disqualify the individual for the duration of unemployment (see Table 1). In most of these states, individuals cannot receive benefits until they have had earnings and employment in another job. Over time, state laws have become more restrictive in their definition of good cause for voluntary leaving. Laws have focused more exclusively on reasons attributable to employment and have reduced the frequency with which reasons related to the worker's personal circumstances are considered (Blaustein 1993). Table 3 displays the reasons that are explicitly considered good cause for voluntary leaving in state *law*. Thirty-eight states restrict good cause to issues connected with work or attributable to the employer.

Table 4 displays the ICESA survey results regarding reasons for good cause in leaving a job. The survey results indicate that when individuals leave a firm due to *new employment circumstances,* such as a change in work hours, they are eligible in 15 states, and potentially eligible (that is, eligibility varies based on the circumstances) in another 25 states.[10] One specific question was asked regarding employment-related situations—whether a worker completing an assignment with a temporary agency is considered to have "quit." The survey found that individuals in this situation were definitely eligible in only 5 states and potentially eligible in 26 of the states.

Another question regarding employment circumstances related to harassment on the job. In only 7 states are there explicit statutes that allow individuals who have left their jobs due to sexual or other discriminatory harassment to be eligible for benefits (U.S. Department of Labor 1994). According to the ICESA survey, however, such individuals are eligible for UI benefits in 44 states. This indicates that harassment is much more commonly recognized as good cause for leaving employment than is indicated in state law.

The remainder of the survey section on voluntary leaving addressed personal issues. According to the survey, 38 states do not consider new personal circumstances good cause. One type of personal circumstance relates to domestic or marital obligations. Few state statutes explicitly identify reasons related to marital obligations as *not* being good cause for voluntary termination.[11] The ICESA survey results, however, indicate that a much larger number of states consider reasons related to marital obligations not to be good cause for voluntary separation. As Table 4 indicates, the ICESA survey found that 47 states disqualify a UI applicant for voluntarily leaving work to marry, 38 states disqualify a UI applicant for leaving work to move with a spouse, and 32 states disqualify a UI applicant for leaving to perform marital or domestic obligations.

Another type of personal circumstance relates to physical condition, including illness, injury, or pregnancy. The laws in 28 states generally render individuals ineligible for benefits when they leave work due to an "illness" (see Table 3). The ICESA survey indicated that states are likely to render ineligible those who are pregnant (ineligible in at least 35 states) or who have an illness or injury (ineligible in 36 states), unless they left employment under the advice of a physician (ineligible in only 3 states for both circumstances).

A final type of personal circumstance occurs when an individual leaves a job in good faith with the intention of accepting another job but circumstances then prevent the new job from being accepted. According to state statute, such an individual would be eligible to receive benefits in 17 states (see Table 3). The survey finds a slightly higher number of states would most likely consider this individual eligible (22 states).

Misconduct and Gross Misconduct

Misconduct is another category of disqualification related to job separation (see Table 1 for details). Examples of misconduct may include a violation of company rules, insubordination, refusal to perform assigned work, and absence from work. When an employee is discharged due to misconduct, states deny benefits for part or the entire duration of the current unemployment spell, and some states further reduce the individual's benefits (as indicated by an asterisk in Table 1). About half of the states also define "gross misconduct" (e.g., arson, larceny, forgery), and enforce stricter benefit restrictions in these cases. Such restrictions include denying benefits for longer periods of time, as well as cancelling the individual's earnings history for purposes of determining benefits (indicated by a plus sign in Table 1).

According to the ICESA survey results, in most states, individuals who are discharged for *willfully* violating an employer rule are ineligible for UI benefits. For example, if an individual willfully violated an employer rule and no harm resulted to the employer or other employees, the individual is ineligible in 42 states. In most states, however, when individuals are discharged for *inadvertently* violating an employer rule, they are more likely to be eligible for benefits (eligible in 8 states). In addition, in both instances, individuals are slightly less likely to be eligible when the act results in harm to the employer or other employees (see Table 5). One difficulty with misconduct is defining the concepts of both "willful" and "harm"—these are sometimes prescribed in detail in statute, but are often left to court interpretation.

The survey also posed some additional questions regarding misconduct that are not related to employer rules but addressing specific situations in which misconduct might be alleged. Of these additional circumstances, individuals are least likely to be eligible when they test positive for drug use.

NONSEPARATION ISSUES

Availability and Work Search Requirements

A claimant must be both able to work and available for work in order to be *eligible* for UI benefits. State laws vary with regard to specific requirements on these issues. In 9 states UI claimants must be able and available for work in their usual occupation or in an occupation

that is consistent with their prior training or experience. In 12 states, UI claimants must be able and available for "suitable" work, which is defined differently in each state. The remaining 32 states simply require that UI claimants be able and available for work.

All state laws also require registration for work at a public employment office as evidence of the ability to work (U.S. Department of Labor 1994). In addition, claimants must be looking for work and submit evidence of their job search in accordance with requirements specified in the state law. This is a continuing eligibility requirement. If individuals are ineligible for benefits *solely* because they are deemed unable or unavailable for work, they may receive benefits as soon as that condition changes. For example, a claimant who leaves work with "good cause," such as an illness, may not meet the "able or available" test initially. Most states, however, would allow the individual to become eligible for benefits as soon as he or she was again able and available for work (that is, had recovered from the illness).

As discussed above, a nonseparation determination is often made from information gathered during interactions with the UI office (e.g., submission of ongoing claims forms, interviews) and individuals' responses to job referrals and offers from the Employment Service. The frequency with which claimants must interact with a state's UI office and the extent to which that office follows-up on the information received affects how many nonseparation issues are detected and determined.

There are two primary issues which may affect eligibility for UI claimants seeking work: (1) whether an individual must be seeking part-time or full-time work and (2) whether an individual must be available for all possible work shifts (such as between midnight and 6:00 A.M., or on weekends). These are discussed below.

Seeking Part-Time Work

Statutes in 3 states require that a claimant be available for full-time work (U.S. Department of Labor 1994).[12] The ICESA survey addressed this issue specifically, asking whether individuals must be seeking full-time work and whether an individual must be available for all possible work shifts. The survey results for a variety of situations indicate that, in general, individuals are ineligible for benefits in 39 states if they are seeking *only part-time work.*[13] In 13 states, the eligibility conditions vary significantly based on an individual's circumstances, and

in only 1 state is an individual who is seeking only part-time work eligible for benefits under most conditions.

In general, it is only in certain limited circumstances that some states report that individuals seeking part-time work are eligible for benefits. For example, when seeking part-time work, individuals who have a history of part-time work are eligible in 13 states, students are eligible in 9 states, and individuals who are under a physician's advice to work part-time due to a physical or mental condition are eligible in 10 states.[14] States, however, are extremely unlikely to consider individuals eligible for benefits when they seek part-time work due to compelling personal circumstances (3 states), domestic circumstances (2 states), or personal preference (no states). (See Table 6.)

Restricting Available Hours

When individuals restrict their available hours (that is, exclude specific shifts, hours, or days) but remain available *for the hours that are normally worked in their occupation in the locality*, the ICESA survey results indicate that most states consider them eligible (43 states). In the absence of this condition, however, states are unlikely to consider individuals eligible, despite the presence of other potentially extenuating circumstances. For example, individuals restricting hours due to a physical or mental condition are eligible in 12 states,[15] due to compelling personal circumstances in 8 states, due to domestic circumstances in 7 states, due to transportation limitations in 6 states, and due to student status in 4 states (see Table 6). Finally, the survey indicates (by the large number of state responding in the "varies" category) that some specific or unique circumstances may allow an individual to be eligible for benefits even when hours are restricted.

Refusal of Suitable Work Without Good Cause

Refusal of suitable work is a nonseparation issue; however, it is treated as a disqualification and laws in 40 states explicitly deny benefits for the duration of unemployment. Table 1 indicates how states penalize claimants who refuse to accept "suitable" work. The definition of suitable work confronts complex issues (discussed below) related to the number of hours and the exact type of work for which a UI claimant must be available. In order to protect

workers from unreasonable job demands, all states define suitability on issues of health, morality, safety, and labor standards. In defining suitability, some state laws also include standards regarding travel distance to work,[16] relationship of job to previous experience and skills, and length of unemployment.[17]

According to the ICESA survey, in 44 states, individuals are eligible for benefits if they refused work with "good cause" (see Table 7). The definition of good cause, however, varies significantly by state and is typically not an absolute standard; rather, it is considered on a case-by-case basis.[18] In many states, individuals are eligible if the job offer is not in their previous occupation (eligible in 24 states), pays significantly less than prior employment (31 states), is for temporary or commission work when they have no prior history in that type of work (30 states), or is refused due to a physical or mental condition (28 states). In most states, however, individuals are *ineligible* if the job offer is for full-time work and they are seeking part-time work (ineligible in 37 states), is refused due to domestic circumstances (28 states), or is for temporary or commission work and they have a prior history of this type of work (25 states).

CONSISTENCY OF DETERMINATIONS WITHIN STATES

In each of 5 states, a survey was distributed to approximately 30 state UI employees who determine nonmonetary eligibility either at the initial claims level or for lower-authority appeals. The purpose of this survey was to determine the consistency with which determinations would be made by claims examiners *within* a state for a variety of specific circumstances. The survey included questions that were also used in the ICESA state survey, as well as additional hypothetical cases. The respondents were asked to determine eligibility in each set of circumstances. Further, respondents were asked to rank categories of nonmonetary eligibility issues on the basis of general difficulty in making determinations.

In general, the responses to eligibility questions were quite consistent within each state in each set of circumstances. The only nonmonetary eligibility questions that resulted in internally inconsistent answers (in 4 of the 5 states) related to *refusal of suitable work.* It should be noted that a majority of respondents in these states recognized this difficulty, ranking refusal of suitable work as the first or second most difficult type of case to determine. Finally, a comparison of claims examiners' responses in each state with those of the state agency (i.e., UI

directors' responses to the ICESA survey) indicated that in most instances, the two different sets of responses were consistent. In two states, the expected agency result and the claims examiners' average responses differed somewhat on 1 of 13 questions; in one state, responses differed somewhat on 2 of 13 questions; and in two states, there were no significant differences in response.[19] Overall, these results suggest that there is considerable consistency in the determinations of claims examiners within a state, and that their decisions usually reflect the expected state agency result.

VALIDITY OF NONMONETARY SURVEY

On the issue of seeking only part-time work, the ICESA survey results can also be compared to a legal review of each state's statute, rules and regulations, and administrative and judicial case law (National Employment Law Project 1994).[20] This comparison provides a partial check of the validity of the ICESA survey. The legal review indicates that in 24 states an individual seeking part-time work is *ineligible* for UI benefits (see Table 8).[21] In 96 percent of those states (23 of 24), the results of the ICESA survey also conclude that the individual is generally ineligible. (In the only remaining state, the survey indicated that eligibility varied.)

The legal review indicates that in 10 states, an individual limiting work search to part-time work is *eligible*; however, restrictions regarding eligibility often apply. According to the legal analysis, there were two primary conditions under which an individual seeking part-time work would be eligible: (1) if the individual had a history of part-time work and (2) if the individual had good cause to seek part-time work.[22] Of the 10 states in which the legal analysis identified such individuals as eligible, the ICESA survey found the following: in 8 of the 10 states, individuals are eligible if they have a prior part-time work history; in 7 of the states individuals are eligible if they have a medical condition; and in 5 of the states individuals are eligible if they have compelling personal reasons. Thus, there was significant overlap in the survey responses and the legal review. These results suggest that the ICESA survey is a valid reflection of states' legal positions on nonmonetary eligibility conditions.

POLICY DISCUSSION

Overall, the survey results suggest a number of issues that merit additional consideration. First, the results confirm the observation that nonmonetary eligibility requirements vary significantly across states and that eligibility is often dependent on the specific circumstances of a given case. These conditions exacerbate the problems created by the general lack of published information regarding state nonmonetary eligibility conditions, and are likely to increase misunderstandings among claimants and employers regarding nonmonetary eligibility. Such misunderstandings harm both groups, and may also place strains on the resources of the UI system by causing additional appeals.

Second, the application of many of the nonmonetary eligibility requirements creates problems for a number of specific groups. Despite the many changes in the labor market since the inception of the UI program, and there have been few modifications in UI nonmonetary eligibility requirements in order to accommodate the realities of today's labor market.

There have been numerous changes in the labor market since the Unemployment Insurance system was created in 1935. At that time, the labor force consisted primarily of men who worked full-time. Women were primarily full-time homemakers. Today, women comprise almost half of today's labor force and a significant number of individuals work part-time.[23] At the inception of the UI system, there was typically one nonworking parent at home; the increase in women's labor force participation, however, has resulted in a large number of two-earner families.

Despite women's increased participation in the workforce, women continue to bear a disproportionate share of care-giving responsibilities. As a result, women enter and exit the job market frequently, due to both child-bearing and care-giving responsibilities. This can be seen by analyzing unemployment by reason—women are much more likely than men to be unemployed because they are re-entering the labor force.[24]

Today's workforce is also much more mobile than before; the entire nation, rather than just the city or state of residence, may now be seen as a potential job market. Finally, there has been an increased dispersion in the income distribution of families, resulting in an overall increase in the number of families in poverty.[25] These trends point generally to four groups of workers—women, low-wage workers, contingent workers (i.e., part-time or temporary workers), and two-earner families—who may face particular difficulty receiving UI under the current

nonmonetary eligibility conditions. Although there is some significant overlap in these four categories, they are discussed separately.

Women

Women are more likely than men to be the care givers in a family, despite their increasing labor force participation. In addition, they are more likely to be single parents. As a result, women are disproportionately affected by responsibilities that are borne by single parents, as well as by parents in two-earner families. When both short-term and long-term domestic and care-giving emergencies arise, the burden is likely to fall on women and single parents, who are more likely to leave their jobs. In the majority of states, these individuals would be ineligible for benefits for leaving employment without good cause, because this is a personal reason unrelated to the job. In addition, even if an individual was able to receive UI in one of the few states which considered domestic responsibilities good cause for leaving a job, she may be considered unavailable for work if she restricted her hours of availability due to care-giving responsibilities.

Another problem women may face is receiving UI benefits during and after pregnancy. According to federal Unemployment Insurance law (Federal Unemployment Tax Act), a woman cannot be denied Unemployment Insurance "solely on the basis of pregnancy."[26] Still, women who must leave their job due to complications related to the pregnancy may not be able to receive UI—in some states it is not considered good cause for quitting, and in other states it is good cause only with specific physician's advice. Even if the separation is viewed by the state as valid, the woman may be considered unavailable for work simply because she has left her previous job because of pregnancy or because she is seeking a different type of job (since her previous one is no longer suitable). She may also be considered unavailable if she needs to restrict her hours due to the pregnancy (e.g., to 30 hours a week).

Finally, women who quit after experiencing sexual harassment at work may not receive UI. (The same is true for men who are sexually harassed, and others who experience discriminatory or personal harassment.) As noted above, while only 7 states have explicit statutes allowing individuals to receive UI if they leave their jobs due to sexual or other discriminatory harassment, the ICESA survey indicated that individuals are likely to be eligible in at least 44 states. Thus, it appears that harassment is viewed in most states as a valid reason for leaving a

job. Even in those states, however, there may be problems in how sexual harassment is defined (with regard to exact behavior and whether management was notified) when determining an individual's ability to receive benefits. These problems may result in ineligibility for UI for individuals who have experienced harassment on the job.

Low-Wage Workers

Low-wage workers (who are disproportionately likely to be women, minorities, and part-time workers) are disproportionately affected by two specific types of nonmonetary eligibility requirements. First, low-wage workers may have difficulty in locating affordable child care. Therefore, when there are changes in their access to child care or changes in their work schedule, they may be unable to make a quick adjustment. This could result in an initial disqualification (e.g., leaving work without good cause), or could pose significant problems during job search when they are receiving UI. For example, an individual may be considered unavailable for work if he or she cannot afford full-time child care while unemployed. This is because of his or her inability to accept full-time employment.

A second significant problem that disproportionately affects low-wage workers is having access to transportation to and from work. Even in some urban areas, transportation may only be available at certain times during the day or certain days of the week. In rural areas, the availability of public transportation is likely to be even more limited. Low-wage workers may not be able to adjust to changes in their work schedule (e.g., night shift work) if existing sources of transportation are not available to accommodate a new schedule. In addition, even if low-wage workers had a valid separation reason, they may be considered *unavailable for work* and ineligible for UI benefits if they restrict their available hours for work to accommodate available public transportation.

Part-Time and Temporary Workers

Part-time and temporary workers (who are more likely to be women) are disproportionately affected by a number of nonmonetary eligibility provisions. Even if part-time workers meet all monetary eligibility requirements, the decision to seek only part-time work (and not full-time work) results in a determination of *unavailable for work* and temporary ineligibility

for UI benefits in most states. Working mothers make up a significant percentage of part-time workers, and their wages from employment often represents an essential part of household income. Both the National Commission on Unemployment Compensation and the Advisory Council on Unemployment Compensation have recommended abolishing the automatic disqualification for part-time workers which exists in the vast majority of states.[27] Seeking part-time work can also lead to a disqualification for refusing suitable work, which in many states results in UI ineligibility for the duration of unemployment.

Another set of issues directly affects the UI eligibility of individuals working for temporary-help agencies. In many states (between 20 and 24, depending on the specific type of disqualification), unemployed individuals who meet the UI monetary eligibility requirements are nevertheless ineligible for benefits when they (1) complete a work assignment with a temporary agency, or (2) have a prior history of temporary (or commission) work and refuse a subsequent offer of temporary (or commission) work. This restriction could make it difficult for the growing number of temporary workers to seek and find permanent work.

Two-Earner Families

There are a number of nonmonetary eligibility issues that face single, working parents and/or two-earner families. The growth in the number of two-earner families, and the corresponding decrease in the number of families with one *nonworking* parent, is a direct result of women's increased labor force participation. When parents work, it is much more difficult for families to adapt to new or changing care-giving responsibilities, or changes in scheduled work hours. For example, in at least 12 states, individuals who leave their job due to a change in their employment situation (for example, a change in scheduled work hours) are determined to be ineligible for benefits. As mentioned earlier, these types of care-giving responsibilities are more likely to be assumed by women, but may affect either working parent. These types of changes in an employment situation could cause significant hardship for workers with child care and other care-giving responsibilities.

Another eligibility issue facing two-earner families arises if the family needs to move, either because one spouse (or partner) accepts a job in another location or is transferred by his or her current employer.[28] As society and the job market become increasingly mobile, this type

of situation is happening more frequently. In these instances, one spouse may be temporarily unemployed and searching for a job in the new location. In at least 38 states, the individual is likely to be ineligible for UI; they are not considered to have good cause for voluntarily leaving their prior job.

Conclusion

In conclusion, the survey results suggest two primary areas for policy reform. First, clarification of state nonmonetary eligibility conditions in state laws, and distribution of these materials to both claimants and employers could partially remedy the current lack of knowledge concerning these determinations. Second, the current nonmonetary eligibility conditions across the states should be reviewed and revised so that state UI systems are more responsive to the realities of today's labor market. These conditions should ensure that the system is responsive to the needs of individuals who have a significant attachment to the labor force and who often involuntarily face a number of work and family situations that currently may directly or indirectly restrict their UI eligibility.

TABLE 1. Duration (in weeks) of Various UI Disqualifications, by State, 1994

State	Voluntary Leaving	Discharge for Misconduct	Additional Penalty for Discharge for Gross Misconduct	Refusal of Suitable Work
Alabama	Duration*	3-7*	Duration+	1-10
Alaska	5*	5*	—	5*
Arizona	Duration	Duration	—	Duration
Arkansas	Duration	7	Duration	7
California	Duration	Duration	—	1-9
Colorado	10*	10*	26*	20*
Connecticut	Duration	Duration	—	Duration
Delaware	Duration	Duration	—	Duration
District of Columbia	Duration	Duration	—	Duration
Florida	Duration	Duration	Duration	Duration*
Georgia	Duration	Duration*	Duration	Duration
Hawaii	Duration	Duration	—	Duration
Idaho	Duration	Duration	—	Duration
Illinois	Duration	Duration	+	Duration
Indiana	Duration*	Duration*	+	Duration*
Iowa	Duration	Duration	+	Duration
Kansas	Duration	Duration	Duration+	Duration
Kentucky	Duration	Duration	Duration	Duration
Louisiana	Duration*	Duration*	Duration+	Duration
Maine	Duration	Duration	Duration	Duration
Maryland	Varies	5-10	Duration	5-10
Massachusetts	Duration	Duration	—	7*
Michigan	Duration	Duration	Duration*	6*
Minnesota	Duration	Duration	Duration+	Duration
Mississippi	Duration	Duration	—	1-12
Missouri	Duration	4-16	4-16	Duration
Montana	Duration	Duration	52*	Duration*
Nebraska	Varies*	7-10*	+	7-10*
Nevada	Duration	Duration	+	Duration
New Hampshire	Duration	Duration	4-26+	Duration
New Jersey	Duration	5	Duration+	3
New Mexico	Duration	Duration	—	Duration*
New York	Duration	Duration	52	Duration
North Carolina	Varies*	Varies	—	Varies
North Dakota	Duration	Duration	52	Duration
Ohio	Duration	Duration	+	Duration
Oklahoma	Duration	Duration	—	Duration
Oregon	Duration*	Duration*	+	Duration*
Pennsylvania	Duration	Duration	—	Duration
Puerto Rico	Duration	Duration	—	Duration
Rhode Island	Duration	Duration	—	Duration
South Carolina	Duration	5-26*	5-26*	Duration
South Dakota	Duration	Duration	—	Duration
Tennessee	Duration	Duration	—	Duration
Texas	Duration	Duration	—	Duration
Utah	Duration	Duration	51	Duration
Vermont	Duration	6-12	Duration	Duration
Virgin Islands	Duration	Duration	—	Duration
Virginia	Duration	Duration	—	Duration
Washington	Duration	Duration	+	Duration
West Virginia	Duration	6*	Duration	4*
Wisconsin	Duration	Duration*	—	Duration
Wyoming	Duration	Duration*	—	Duration

NOTES: An asterisk (*) indicates that, in addition to the duration of the disqualification noted in the table, a state *reduces* the benefit amount a claimant receives at the end of the disqualification period. A plus (+) indicates that the individual's earned credits are canceled. A dash (—) indicates that there are no additional penalties for gross misconduct.

SOURCE: U.S. Department of Labor (1994).

TABLE 2. Duration of Penalty Imposed for Various UI Disqualifications, Over Time, by Number of States

Reason for Disqualification and Year	No. of States That Postpone Benefits for:[a]		No. of States That Reduce or Cancel Benefits
	Fixed or Variable Number of Weeks	Duration of Unemployment	
Voluntary Leaving			
1948	41	11	16
1971	35	28	19
1978	17	42	11
1994	5	51	8
Misconduct Discharge[b]			
1948	46	6	16
1971	41	20	18
1978	31	30	16
1994	12	42	12
Suitable Work Refusal			
1948	40	12	17
1971	35	23	16
1978	32	26	14
1994	13	41	11

SOURCES: Blaustein (1993, 284) and U.S. Department of Labor (1994).

[a] Some states are counted as having both a denial period of a fixed or variable number of weeks and a durational disqualification for a given reason category. In these instances, the severity of the penalty imposed is based on the individual circumstance.

[b] Count excludes disqualification for gross misconduct.

TABLE 3. Good Cause for Voluntary Leaving, According to State Laws, by State, 1994

State	Restricted to Work/Employer (not Personal)	Sexual or Unwelcome Harassment	To Accept Other Work[a]	Claimant's Illness
Alabama	X	—	X	X
Alaska	—	—	—	—
Arizona	X	—	—	—
Arkansas	X	—	—	X
California	—	X	—	—
Colorado	X	—	—	X
Connecticut	X	—	X	X
Delaware	X	—	—	X
District of Columbia	X	—	—	—
Florida	X	—	X	X
Georgia	X	—	—	—
Hawaii	—	—	—	—
Idaho	X	—	—	—
Illinois	X	X	X	X
Indiana	X	—	X	X
Iowa	X	—	—	X
Kansas	X	X	—	X
Kentucky	X	—	—	—
Louisiana	X	—	—	—
Maine	X	—	X	X
Maryland	X	—	—	X
Massachusetts	X	X	X	X
Michigan	X	—	X	—
Minnesota	X	X	X	X
Mississippi	X	—	—	—
Missouri	X	—	X	—
Montana	X	—	—	—
Nebraska	—	—	—	—
Nevada	—	—	—	—
New Hampshire	X	—	—	X
New Jersey	X	—	—	—
New Mexico	X	—	—	—
New York	—	—	—	—
North Carolina	X	—	—	X
North Dakota	X	—	X	X
Ohio	—	—	X	—
Oklahoma	X	—	—	—
Oregon	—	—	—	—
Pennsylvania	—	—	—	—
Puerto Rico	—	—	—	—
Rhode Island	—	X	—	—
South Carolina	—	—	—	—
South Dakota	X	—	X	X
Tennessee	X	—	—	X
Texas	X	—	X	X
Utah	—	—	—	—
Vermont	X	—	—	X
Virgin Islands	—	—	—	—
Virginia	—	—	—	—
Washington	X	—	X	X
West Virginia	X	—	X	X
Wisconsin	X	X	X	X
Wyoming	X	—	—	X

SOURCE: U.S. Department of Labor (1994).

[a] Type of job varies by state but might include leaving in good faith to accept full-time work with another employer or accepting another job while on layoff.

TABLE 4. Categorizing Nonmonetary Eligibility Status Under Various Conditions, by Number of States, 1994
ISSUE: "Voluntary Leaving with Good Cause"

Individual Voluntarily Left Job:	Eligible[a] (no. of states)	Varies[a] (no. of states)	Ineligible[a] (no. of states)
Due to new *employment* circumstances.	15	25	13
After the completion of assignment with temporary agency.	5	26	20
Due to sexual or other discriminatory harassment.	44	9	0
Due to new *personal* circumstances.	8	7	38
To move to marry.	5	1	47
To move with spouse to another locality.	9	6	38
To perform other marital or domestic obligations (e.g., illness in family).	8	13	32
Due to domestic violence.	13	9	31
Due to illness or injury without physician's advice.	1	16	36
Due to illness or injury with physician's advice.	39	11	3
Due to pregnancy without physician's advice.	2	16	35
Due to pregnancy with physician's advice.	40	10	3
In good faith to accept another job.	22	8	23

NOTE: Surveys were received from all 50 states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

SOURCE: This table shows the results from a survey conducted by the Interstate Conference of Employment Security Agencies (ICESA). The survey is meant to reflect the expected Unemployment Insurance agency result, assuming that nonmonetary eligibility decisions are consistent with the applicable state policies.

[a] The response categories are grouped as follows: "always eligible" and "usually eligible" are displayed as eligible, "often varies" is displayed as varies, and "rarely eligible" and "never eligible" are displayed as ineligible.

TABLE 5. Categorizing Nonmonetary Eligibility Status Under Various Conditions, by Number of States, 1994
ISSUE: "Misconduct Violations"

Individual Situation:	Eligible[a] (no. of states)	Varies[a] (no. of states)	Ineligible[a] (no. of states)
Individual *willfully* violated employer rule and employer/other employees were *harmed.*	0	1	52
Individual *willfully* violated employer rule and employer/other employees were *not harmed.*	4	7	42
Individual *inadvertently* violated employer rule and employer/other employees were *harmed.*	19	23	11
Individual *inadvertently* violated employer rule and employer/other employees were *not harmed.*	30	15	8
Individual did not *willfully* intend to harm employer/other employees.	31	19	3
Individual could not reasonably foresee the harm the actions would create.	15	26	12
Individual *inadvertently* commits act that results in large monetary loss to employer.	21	27	5
Individual was repeatedly absent for valid personal reason.	17	25	11
Individual tested positive for drugs but did not show any on-the-job possession or impairment.	6	27	19

NOTE: Surveys were received from all 50 states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

SOURCE: This table shows the results from a survey conducted by the Interstate Conference of Employment Security Agencies (ICESA). The survey is meant to reflect the expected Unemployment Insurance agency result, assuming that nonmonetary eligibility decisions are consistent with the applicable state policies.

[a] The response categories are grouped as follows: "always eligible" and "usually eligible" are displayed as eligible, "often varies" is displayed as varies, and "rarely eligible" and "never eligible" are displayed as ineligible.

TABLE 6. Categorizing Nonmonetary Eligibility Status Under Various Conditions, by Number of States, 1994
ISSUE: "Able and Available for Work"

Individual Situation:	Eligible[a] (no. of states)	Varies[a] (no. of states)	Ineligible[a] (no. of states)
Individual is seeking part-time work:			
Due to personal preference.	0	6	47
Due to compelling personal circumstances.	3	8	42
Due to domestic circumstances (e.g., care giving).	2	7	44
On physician's advice, due to physical, mental, or medical condition	10	9	34
And has a prior part-time work history.	13	9	31
And has student status.	9	9	35
Aggregated response (based on all eight categories).	1	13	39
Individual is restricting hours available (excluding specific shifts, hours, or days) in seeking work:			
That satisfy those normally worked in occupation in locality.	43	5	5
Due to personal preference.	3	8	42
Due to compelling personal circumstances.	8	18	27
Due to domestic circumstances (e.g., care giving).	7	16	30
Due to physical, mental, or medical condition.	12	22	19
Due to transportation limitations.	6	14	33
And has student status.	4	16	33

NOTE: Surveys were received from all 50 states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

SOURCE: This table shows the results from a survey conducted by the Interstate Conference of Employment Security Agencies (ICESA). The survey is meant to reflect the expected Unemployment Insurance agency result, assuming that nonmonetary eligibility decisions are consistent with the applicable state policies.

[a] The response categories are grouped as follows: "always eligible" and "usually eligible" are displayed as eligible, "often varies" is displayed as varies, and "rarely eligible" and "never eligible" are displayed as ineligible.

TABLE 7. Categorizing Nonmonetary Eligibility Status Under Various Conditions, by Number of States, 1994
ISSUE: "Refusal of Suitable Work"

Individual refused:	Eligible[a] (no. of states)	Varies[a] (no. of states)	Ineligible[a] (no. of states)
A job with *good cause*.	44	9	0
An offer of full-time work because of seeking part-time work.	2	14	37
An offer of part-time work because of seeking full-time work.	13	28	12
A job not in previous (customary) occupation.	24	27	2
A full-time job due to domestic circumstances.	7	18	28
A part-time job due to domestic circumstances.	13	22	18
A job due to physical, mental, or medical condition.	28	20	5
A job because it paid significantly less than prior employment.	31	20	2
A job because of travel time or transportation problems.	9	32	12
An offer of temporary or commission work (with no prior history of such work).	30	22	1
An offer of temporary or commission work (with recent history of such work).	8	20	25

NOTE: Surveys were received from all 50 states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

SOURCE: This table shows the results from a survey conducted by the Interstate Conference of Employment Security Agencies (ICESA). The survey is meant to reflect the expected Unemployment Insurance agency result, assuming that nonmonetary eligibility decisions are consistent with the applicable state policies.

[a] The response categories are grouped as follows: "always eligible" and "usually eligible" are displayed as eligible, "often varies" is displayed as varies, and "rarely eligible" and "never eligible" are displayed as ineligible.

TABLE 8. Comparing the ICESA Survey Results to a Legal Review, by Number of States, 1994
ISSUE: "Able and Available for Work—Seeking Only Part-time Work"

Legal Review Results	ICESA Survey Results		
	Eligible[a] (no. of states)	Varies[a] (no. of states)	Ineligible[a] (no. of states)
Eligible (10 states)	0	6	4
Ineligible (24 states)	0	1	23
No Authority (12 states)	0	3	9
Conflicting Authority (7 states)	1	3	3

NOTES: Surveys were received from all 50 states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands.

The Interstate Conference of Employment Security Agencies (ICESA) survey results are calculated based on an average response for a series of eight situations.

SOURCES: This table shows the results from a survey conducted by ICESA and a legal analysis conducted by the National Employment Law Project (1994). The survey is meant to reflect the expected Unemployment Insurance agency result, assuming that nonmonetary eligibility decisions are consistent with the applicable state policies. The legal analysis includes a review of state statute, rules and regulations, and administrative and case law.

[a] The response categories are grouped as follows: "always eligible" and "usually eligible" are displayed as eligible, "often varies" is displayed as varies, and "rarely eligible" and "never eligible" are displayed as ineligible.

NOTES

1. For more information on monetary eligibility for UI benefits, see Chapter 7 of Advisory Council on Unemployment Compensation, 1995, *Unemployment Insurance in the United States: Benefits, Financing, and Coverage,* at 91-100.

2. Federal law prohibits a state from denying benefits to individuals who are otherwise eligible if they refuse to accept a job (1) when the job is vacant due to a strike, lockout, or other labor dispute; (2) when wages, hours, or other conditions are substantially less favorable for the individual than those available for similar work in the area; and (3) when a condition of employment is that the individual would be required to join a company union or to resign from (or not be permitted to join) any labor organization. Section 3304(a)(5) of the Federal Unemployment Tax Act, 29 U.S.C. § 3304(a)(5). In addition, benefits cannot be denied solely on the grounds of pregnancy. 29 U.S.C. § 3304(a)(12)(1988).

3. The base period is the relevant time period—in most states, the first four of the most recently completed five calendar quarters, based on the UI application date—that is used to determine eligibility.

4. ICESA represents officials who administer the Employment Service, Unemployment Insurance, Labor Market Information, and, in many cases, the Job Training Partnership Act and Job Opportunities and Basic Skills training programs.

5. Massachusetts, North Carolina, Oregon, Texas, and Wisconsin participated in the survey.

6. Information on how the determination process works is from Corson et al., *Nonmonetary Eligibility in State Unemployment Insurance Programs: Law and Practice*, 1986, at 59-96.

7. The "other" category accounted for the remaining 12 percent.

8. Some research has found that increases in the severity of penalties have significantly decreased the recipiency rate among unemployed individuals. See Advisory Council on Unemployment Compensation, 1994, at 40-41.

9. For information on unemployment resulting from a labor dispute, see Advisory Council on Unemployment Compensation, 1995, at 116-118. For information on fraudulent misrepresentation, see U.S. Department of Labor, *Comparison of State UI Laws*, (1994) at 4-14 through 4-17.

10. These survey results indicate that employer-related issues are not considered to be "good cause" as definitively as is indicated in state statutes. See U.S. Department of Labor, *Comparison of State UI Laws*, at 4-5 through 4-7 and 4-33, 4-34.

11. Six states automatically disqualify a UI applicant for voluntarily leaving work to marry, 8 states automatically disqualify a UI applicant for leaving work to move with a spouse, and 6 states disqualify a UI applicant for leaving to perform marital, domestic, or filial obligations. See U.S. Department of Labor, *Comparison of State UI Laws*, 1994, at 4-13, 4-19.

12. The states are Michigan, New Hampshire, and West Virginia. See U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws*, 1994, at 4-1, 4-2.

13. This is based on calculating an average response for a series of eight situations.

14. Some states noted on their survey responses that individuals covered by the Americans with Disabilities Act *are* considered "available" for work when they are seeking part-time work.

15. Some states noted on their survey responses that individuals covered by the Americans with Disabilities Act *are* considered "available" for work when they are restricting their available hours.

16. The 3 states that include travel distance to work in their definition of suitable work are Delaware, New York, and Ohio. See U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws*, 1994, at 4-9.

17. In some states, the definition of suitable work changes as the duration of the claimant's unemployment grows. Over time, claimants must accept a lower offered wage. The 11 states with such provisions include Florida, Georgia, Idaho, Iowa, Louisiana, Maine, Mississippi, Montana, North Dakota, Utah, and Wyoming. See U.S. Department of Labor, *Comparison of State Unemployment Insurance Laws*, 1994, at 4-10.

18. This is indicated by the large number of responses in the "often varies" category.

19. The maximum difference between responses was 59 percent on a refusal of suitable work question and the next highest difference was 28 percent, also on a suitable work question.

20. National Employment Law Project (materials submitted to ACUC, 1994) notes that their summary of administrative case law is not definitive; it is based on Commerce Clearing House (1994).

21. In addition, in 19 states, National Employment Law Project (materials submitted to the ACUC, 1994) identified either no authority on the issue (12 states) or conflicting authority between the statute and other sources (7 states). For these states, the survey results conclude that the individual in question would be eligible in 1 state, ineligible in 12 states, and that eligibility varies in 6 states.

22. According to the National Employment Law Project (materials submitted to ACUC, 1994) legal review, 1 state requires that an individual have a history of part-time work (Colorado), 3

states require that an individual have "good cause" for the restriction or that the restriction is "beyond their control" (Delaware, District of Columbia, and Illinois), 2 states require a combination of these two (Massachusetts and New Jersey), 2 states require that the individual seek a minimum number of working days per week (Montana and Washington), and 2 states have no restrictions (California and Ohio).

23. Twenty-eight percent of employed women work part-time, whereas only 11 percent of employed men work part-time. See U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, 1994 at 172 (Table 8).

24. Among unemployed women, 33 percent are reentrants and 50 percent are job losers. Among unemployed men, the numbers are 17 percent and 70 percent, respectively (Unpublished data from U.S. Department of Labor, Bureau of Labor Statistics, December 1993).

25. In 1970, 10.1 percent of families lived in poverty; in 1980, 10.3 percent of families lived in poverty, and in 1992, 11.7 percent of families lived in poverty. See U.S. Bureau of the Census, *Statistical Abstract of the United States: 1994*, at 479 (Table 735).

26. See 29 U.S.C. § 3304(a)(12)(1988).

27. National Commission on Unemployment Compensation, *Unemployment Compensation: Final Report*, 1980, at 48-49 and Advisory Council on Unemployment Compensation, 1995, at 18.

28. According to McHugh and Kock, "Unemployment Insurance: Responding to the Expanding Role of Women in the Workforce," *Clearinghouse Review*, 1994, (p. 1429) women are more likely to follow their spouse (or partner) than men.

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Advisory Council on Unemployment Compensation

Proposals for Extended Benefits

Contract No. M-4344-3-00-97-30

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KRA Corporation
Robert F. Cook
Anthony Brinsko
Alexandra Tan

Glossary

AIUR	Adjusted Insured Unemployment Rate
CBO	Congressional Budget Office
E	Enactment date
EB	Extended Benefits
EUC	Emergency Unemployment Compensation
EUCA	Extended Unemployment Compensation Account
ESAA	Employment Security Administration Account
FSC	Federal Supplemental Compensation program
FUTA	Federal Unemployment Tax Act
IUR	Insured Unemployment Rate
OSUB	Optional Supplemental Unemployment Benefits
STUR	Seasonally Adjusted Total Unemployment Rate
XR	Exhaustion Rate

Proposals for Extended Benefits

Since 1989, nearly 40 bills have been introduced in Congress to provide benefits for Unemployment Insurance (UI) recipients who have exhausted their regular UI benefits. These bills can be grouped into roughly three categories. They are

- Bills that modify the existing Extended Benefit (EB) program
- Bills that repeal the EB program and set up a Federal Supplemental Compensation (FSC) program
- Bills that modify the Emergency Unemployment Compensation (EUC) program

Thirty-five major bills were reviewed for this paper. Summaries of the major provisions of each bill relating to the EB, EUC, or FSC programs can be found in the Appendix.

The majority of the bills (25) introduced since 1989 have attempted to modify or extend the EUC program. Nine bills have attempted to extend or modify the EB program, while four have sought to repeal the EB program and replace it with an FSC program. One bill (H.R. 1296 in the 102nd Congress) created an optional Supplemental Unemployment Benefit program that States could elect to use in lieu of the EB program. Finally, three bills modified both the EUC and the EB programs.

The number of related bills introduced in Congress has followed a cyclical pattern. Members of Congress introduced the majority of the bills during the peak of the recession. Only three bills related to EB or other programs for UI recipients after they exhaust their benefits were introduced between 1989 and 1991. However, in 1991, a total of 19 bills were proposed in Congress. Of these, 13 related to EUC provisions, 4 to FSC provisions, 1 to EB provisions, and 1 to both FSC and EB provisions. In 1992, the number of bills fell to nine. All of these bills related to the EUC program, although four also modified the EB program. The number of related bills introduced fell further in 1993 to four. All four concerned the EUC program.

The remaining sections of the paper discuss the various policy options proposed in the bills reviewed. In particular, the triggers used to activate programs, the duration of benefits received, the financing mechanisms used, and any changes made in eligibility requirements are discussed. In addition, some of the provisions of the EUC proposals are discussed.

Triggers

A variety of triggering mechanisms for EB, EUC, or FSC have been proposed in Congress since 1989. Following are the five different triggers found in legislative proposals between 1989 and 1993:

- Insured Unemployment Rate (IUR)
- Adjusted Insured Unemployment Rate (AIUR)
- Seasonally adjusted Insured Unemployment Rate (SIUR)

- Total Unemployment Rate (TUR)
- Seasonally adjusted Total Unemployment Rate (STUR)
- Exhaustion rates (XR)

Although most bills only used one type of trigger, some bills combined different types of triggers. Triggers may be used to trigger benefits on or off at the national, State, or substate level. The following sections describe the most common trigger provisions proposed and the levels at which they were proposed.

National Triggers

Only four bills proposed use national triggers to activate benefits. Three of these bills (H.R. 1367, H.R. 2839, and H.R. 3040 in the 102nd Congress) use either the national TUR or a STUR as a temporary trigger for the FSC program. The fourth bill (H.R. 5260) uses a national trigger to determine the number of weeks of benefits a recipient is eligible to receive based on the national STUR.

State Triggers

State-level triggers are used in all of the proposed or already existing programs. The most commonly proposed trigger was the use of the TUR, which was included in 13 proposals. Next most common was the seasonally adjusted TUR proposed in eight bills. The AIUR was included in five proposals. The IUR, SIUR, and XR were each proposed in two bills. Thresholds, in which the appropriate rate must be some percentage higher than the previous average for the same rate, were included in 10 proposals.

The use of a given type of trigger for extended benefits does not tell the whole story. In 11 bills, multiple triggers were proposed. The most common combination (six proposals) was the STUR combined with a threshold. The combination of the SIUR, TUR, and SIUR and a threshold was proposed twice. The combination of IUR, TUR, XR; the IUR and TUR in combination with a threshold; and IUR and XR with a threshold each were proposed in one bill. The most prevalent trigger proposed, either by itself or in combination with other triggers or thresholds, was the TUR.

Substate Triggers

Only three bills proposed using substate triggers to activate substate programs. Since two of these bills were identical (H.R. 2425 introduced in 1989 and H.R. 914 introduced in 1990, both by Pease), only two different programs were proposed. One proposal used the area TUR to trigger benefits on in a given area. Alternatively, the Governor could designate a given area an EB area. Under the proposed plan, individuals who either lived in or whose last place of employment was in the given area would be eligible to receive benefits. The second proposal set up a demonstration program for substate programs. In this plan, only an individual whose last place of employment was in the designated area would be eligible for benefits. Benefits were to have been triggered on using either the SIUR, the STUR, or the TUR for the given area.

Duration

Most of the bills contain provisions that affect the duration of benefits under the given program. Although almost all of these bills determine the length of benefit durations by economic conditions, the bills with variable duration levels differ in the range of weeks and number of levels they provide. For example, one proposal provides for 10, 15, 20, 25, or 30 weeks of benefits, depending on the prevailing economic conditions. Many proposals, however, contain only two levels of benefits. Only three bills set fixed benefit durations.

Financing

Financing provisions vary, but are of four basic types, because of the budget limitations. Under the current budget agreement, there are caps on overall spending, except for declared emergencies. Therefore, one alternative is to declare the extension of unemployment benefits an economic emergency and appropriate additional general funds to cover extended benefits and administration of the program. Not surprisingly, this form of financing was most commonly suggested for Emergency Unemployment Compensation. If the budget cap is to remain in place, there are three general ways to provide revenue to support extended or supplemental benefits. One is to obtain savings in other programs to offset the additional outlays for extended benefits. These financing changes are not detailed here because they do not affect the UI program directly, but only provide a source of funding. A second way to obtain funding under the budget cap is to raise additional Federal Unemployment Tax Act (FUTA) revenues. This can be accomplished by raising the FUTA tax rate, adding an additional surcharge, or raising the Federal taxable wage base. A third way to finance additional benefits is to borrow, either from other UI trust funds or from the General Fund. Often a combination of these latter three methods was proposed. Two of the more creative sources of additional funds proposed were to borrow without repayment from the General Fund and to earmark the income taxes paid on UI benefits to the UI Trust Fund. Other creative ways to increase the flow of funds are to change the allocation of FUTA revenues into the various trust funds or to raise the ceiling on the emergency trust fund to cause more funds to reside in the fund used to support the proposed program change.

Cost Estimates

Cost estimates are provided for proposals for which estimates were prepared by the Congressional Budget Office (CBO). Costs of benefits, which are generally paid out of the EUCA, are presented separately from the cost of administration of the program, which are either appropriated from the Employment Security Administration Account (ESAA) or covered by a separate appropriation. Not presented are cost estimates for other activities included in the proposals, such as job search assistance, demonstration projects, or training. As noted above, also not presented are offsetting revenues that do not affect the operation of the UI program directly.

Eligibility Requirements for EB, EUC, and Supplemental Benefits

Since 1989, only two bills (H.R. 4727 and H.R. 5260, put forward in the 2nd session of the 102nd Congress) have proposed altering the work-search requirement for recipients of EB. Both bills repealed the Federal work-search test requirements that had been enacted in 1977 and returned regulation of the work-search test requirements to the States. H.R. 5260 eventually passed both houses and was enacted as P.L. 102-318.[1] H.R. 3896, proposed in the 2nd session

of the 101st Congress, mandated that EB recipients participate in training programs. H.R. 3896 never passed Congress, however, and, in fact, a similar provision already existed in the UI laws regarding EB.

Since 1989, seven bills have been proposed in Congress to modify other eligibility requirements. The first, H.R. 1367, proposed in the 1st session of the 102nd Congress, would have replaced the EB program with an FSC program. Included in the bill was a clause limiting disqualification for benefits to 10 weeks, except in certain circumstances. H.R. 4227, proposed in the 2nd session of the 102nd Congress and subsequently not passed, changed the eligibility requirements for EUC from those used to determine eligibility for EB to those used to determine regular unemployment benefits. H.R. 4351 and S. 2291 were identical to each other and simply amended the wording of the Federal-State Unemployment Compensation program, allowing greater flexibility in the eligibility requirements. Both were proposed in the 2nd session of the 102nd Congress.

In addition to repealing the Federal work-search requirements in 1992, H.R. 4727 and H.R. 5260 altered other eligibility requirements for EUC benefits. H.R. 4727 included two clauses altering the eligibility requirements for recipients of EUC benefits. The first clause allowed States to set their own eligibility requirements for recipients of emergency benefits. The second clause allowed individuals who had exhausted their emergency benefits to continue receiving emergency benefits, rather than having to reapply for regular benefits. H.R. 5260 contained only the latter of the two clauses in H.R. 4727, and when P.L. 102-318 was enacted, the clause went into effect. H.R. 3167 was enacted as P.L. 103-152 in 1993 and repealed the clause altering the eligibility requirements for recipients of emergency benefits.

Emergency Unemployment Compensation Program Changes

Of the 35 bills proposed in Congress since 1989 reviewed in this report, 21 have contained provisions modifying the EUC program. All bills that modified the triggers for EUC included State triggers. Most of the State triggers were based on either the TUR or the STUR, and several of the bills included threshold triggers. Of the 21 bills containing provisions on the EUC program, 6 were enacted later as public laws. The remaining 15 bills were precursors to the bills that eventually became law. A brief discussion of the laws that were passed and the related bills follows:

- **P.L. 102-107, *Emergency Unemployment Compensation Act of 1991*, 1st Session.** H.R. 3201, proposed August 2, eventually was enacted as P.L. 102-107. It included provisions allowing eligible recipients to receive up to 20 weeks of emergency benefits based on State triggers determined by the TUR, a provision allowing the Governor of the State to trigger extended benefits off in order to allow eligible recipients to receive EUC benefits, and was financed from the EUC account. It was effective from September 1, 1993, to July 4, 1994, and contained a reachback provision to March 31, 1991. Prior to its passage, S. 1554 and H.R. 3175 were proposed. With the exception of a different initial effective date, S. 1554 was identical to H.R. 3201. H.R. 3175 also had a different initial effective date, and it lacked a provision that reduced the number of eligible weeks by the number of weeks of extended benefits received (a clause that both H.R. 3201 and S. 1554 contained).

- **P.L. 102-164, *Emergency Unemployment Compensation Act of 1991*, 1st Session.** H.R. 3757, proposed November 13, was enacted as P.L. 102-164. First, however, it was changed from H.R. 3757 to H.R. 3575, effectively replacing the previous H.R. 3575. It provided for up to 20 weeks of emergency benefits for eligible recipients based on State triggers determined by a combination of the TUR, AIUR, and XR. It was effective from November 17, 1991, to July 4, 1992 (essentially replacing P.L. 102-107), and, like P.L. 102-107, a recipient's eligibility for EUC benefits was reduced by the amount of extended benefits received. It also had a provision allowing the Governor to trigger the extended benefits program off. Its reachback provision applied back to February 28, 1991. It was financed by the EUC account. Prior to its passage, a number of other bills had been proposed, including the following:

  - S. 1722, S. 1945, and H.R. 3588 were very similar to S. 1554. They all allowed up to 20 weeks of emergency benefits, but the triggers were based entirely upon the TUR. S. 1945 would have remained effective until August 1, 1992, while the other two would have terminated on July 4, 1992.

  - H.R. 3400, H.R. 3600, and S. 1791 limited the length of time recipients could receive emergency benefits to 10 weeks. The State triggers were based on the AIUR. H.R. 3400 would have remained in effect until June 30, 1992, but the other two would have remained in effect until July 4, 1992. None of these bills contained provisions allowing the Governor to trigger the extended benefits program off.

  - H.R. 3575 and H.R. 3618 allowed eligible recipients to receive up to 13 weeks of emergency benefits. The State triggers for both were based on the TUR. Both would have remained effective until July 4, 1992, and both had reachback dates of February 28, 1991. H.R. 3575 died when H.R. 3757 was renamed as H.R. 3575.

  - S. 1789 limited eligible recipients to receiving 15 weeks of emergency benefits based on the State AIUR. It contained no provision allowing the Governor to trigger the extended benefits program off, but it would have remained in effect until July 4, 1992.

- **P.L. 102-244, 2nd Session.** P.L. 102-244 was enacted when H.R. 4095 was passed. It increased the number of weeks an eligible recipient could receive emergency benefits without changing any of the triggers associated with P.L. 102-164. The maximum number of weeks a recipient could be eligible for emergency benefits increased to 33 weeks for the period from February 7 to June 13, 1992, but remained the same (20 weeks) for the period between June 13 and July 4. Prior to H.R. 4095, S. 2164 and S. 2173 were proposed. S. 2173 was identical to H.R. 4095, and S. 2164 was nearly identical.

- **P.L. 102-318, *Unemployment Compensation Amendments of 1992*, 2nd Session.** H.R. 5260 was enacted as P.L. 102-318. It altered the amount of emergency benefits an eligible recipient could receive after June 13, 1992, by including a national trigger based on the STUR. It further prohibited Governors from electing to trigger EB off in favor of emergency benefits after March 6, 1993. It extended the emergency program until March 6, 1993, and modified the financing provisions of P.L. 102-164. Finally, it included a clause altering eligibility requirements (see above).

  Prior to its passage, a number of other bills had been proposed:

  - H.R. 4227, H.R. 4351, and S. 2291 all slightly modified the eligibility requirements for recipients of emergency benefits.

  - H.R. 4727 was identical to H.R. 5260, except that it included an additional eligibility clause that amended the EUC program to use State qualification requirements instead of the qualifications under the Federal-State Extended Benefits program.

  - S. 2699 reduced the amount of emergency benefits for which recipients were eligible and extended the EUC program to March 6, 1993.

- **P.L. 103-6, 1st Session.** H.R. 920 was enacted as P.L. 103-6 and extended the EUC program until October 2, 1993. S. 382 was identical, and H.R. 920 passed in lieu of it.

- **P.L. 103-152, *Unemployment Compensation Amendments of 1993*, 1st Session.** P.L. 103-152 was enacted with the passage of H.R. 3167, which extended the EUC program until February 5, 1994, and reduced the amount of benefits recipients were eligible to receive. Prior to the passage of H.R. 3167, H.R. 3074 had been proposed to extend the EUC program to June 30, 1994.

EB and EUC Program Triggers

Currently, there is a difference in the "on" triggers for the EB program and the EUC program. Any eligible recipient can claim emergency benefits. The triggers associated with the EUC program determine the total amount of benefits a recipient is eligible to receive. If a State is in a high unemployment period, the recipient can claim 6 additional weeks of benefits. For the EUC program, a State is considered to be in a high unemployment period if the AIUR of the latest 13 weeks is 5 percent or higher or the TUR of the latest 6 months is 9 percent or higher. On the other hand, the triggers for the EB program determine a recipient's eligibility to receive EB; the EB triggers are based on the STUR. For the EB program to trigger on, the national STUR of the latest 3 months must be at least 6.5 percent and the State STUR of the latest 3 months must be at least 110 percent of the average STUR of the past 2 years. In addition, if the national STUR of the latest 3 months is at least 8 percent and the State STUR of the latest 3 months is at least 110 percent of the average in the previous 2 years, EB recipients are eligible to receive more benefits. Four States (Alaska, California, Puerto Rico, and West Virginia) currently are considered to be in a high unemployment period. Oregon and Washington currently

have 13 weeks of EB triggered "on" based on the STUR, while Puerto Rico has EB triggered "on" based on it's AIUR. The EUC program is due to expire February 5, 1994.

Summary Table

Table 1[2] provides a summary of the provisions of the various proposals that have been made relative to Extended, Emergency, or Supplemental unemployment benefits from 1989 to 1993. Bills that eventually were enacted are shaded. An E is used to indicate effective dates on which the bills that were not enacted. The Appendix provides a synopsis of each of the bills listed in Table 1.

Table 1
Characteristics of Bills Affecting Extended Benefits, Emergency Benefits, and Supplemental Compensation

Year	1989		1990	1991								
Congress	101st, 1st		101st, 2nd	102nd, 1st								
Bill	H.R. 2425	H.R. 2478	H.R. 3896	H.R. 914	H.R. 1367	H.R. 1518	H.R. 2839	H.R. 3040	H.R. 3175	H.R. 3201	H.R. 3400	H.R. 3575
Purpose												
Replaced EB					X	X	X	X				
Modified or Extended EB	X	X	X	X								
Modified Emergency Benefits									X	X	X	X
National Triggers					X		X	X				
State Triggers	X	X	X	X	X	X	X	X	X	X	X	X
IUR		X	X									
AIUR											X	
SIUR	X			X								
TUR	X		X	X		X			X	X		X
STUR	X			X	X		X	X				
XR		X										
Thresholds	X	X	X	X	X		X	X				
Substate Triggers	X		X	X								
SIUR	X			X								
STUR	X			X								
TUR	X		X	X								
Duration	X			X	X	X	X	X	X	X	X	X
Fixed						X						
Based on Econ. Cond.	X			X	X		X	X	X	X	X	X
Financing	X		X	X	X	X	X	X	X	X	X	X
FUTA Tax					X		X	X				X
Wage Base			X		X		X					
EUCA Ceiling			X				X	X				
Borrow from Other Unemp. Accounts					X		X	X				
Auth. Approp. for Admin.									X	X	X	
100% Fed. Financed					X	X	X	X	X	X	X	X
Borrow from General Fund							X	X				X
Flow of Funds												
Income Taxes on UI Benefits								X				
EUC Provisions									X	X	X	X
Reachback									3/31	3/31	3/31	2/28
Start Date									10/6	9/1	10/1	11/3
End Date									7/4	7/4	6/30	7/4
Can Trigger Off EB									X	X		X
Cost Estim. Avail.			X		X		X	X		X	X	X
Other			X		X							
Work Search or Train. Req.			X									
Other Elig. Req.					X							

Table 1
Characteristics of Bills Affecting Extended Benefits, Emergency Benefits, and Supplemental Compensation (continued)

Year	1991										1992	
Congress	102nd, 1st										102nd, 2nd	
Bill	H.R. 3588	H.R. 3600	H.R. 3618	H.R. 3757	S. 1296	S. 1554	S. 1722	S. 1789	S. 1791	S. 1945	H.R. 4095	H.R. 4227
Purpose												
Replaced EB					X							
Modified or Extended EB					X							
Modified Emergency Benefits	X	X	X	X		X	X	X	X	X	X	X
National Triggers												
State Triggers	X	X	X	X	X	X	X	X	X	X		
IUR												
AIUR		X		X				X	X			
SIUR												
TUR	X		X	X		X	X			X		
STUR					X							
XR				X								
Thresholds					X							
Substate Triggers												
SIUR												
STUR												
TUR												
Duration	X	X	X	X	X	X	X	X	X	X	X	X
Fixed												
Based on Econ. Cond.	X	X	X	X	X	X	X	X	X	X	X	X
Financing	X	X	X	X	X	X	X	X	X	X	X	
FUTA Tax				X								
Wage Base												
EUCA Ceiling												
Borrow from Other Unemp. Accounts												
Auth. Approp. for Admin.		X	X	X	X	X	X	X	X	X		
100% Fed. Financed	X	X	X	X	X	X	X	X	X	X	X	
Borrow from General Fund												
Flow of Funds												
Income Taxes on UI Benefits												
EUC Provisions	X	X	X	X		X	X	X	X	X	X	
Reachback	2/28	2/28	2/28	2/28		3/31	3/31	2/28	2/28	2/28		
Start Date	E	11/3	11/3	11/17		10/6	10/6	10/6	10/6	11/17	E	
End Date	7/4	7/4	7/4	7/4		7/4	7/4	7/4	7/4	8/1	7/4	
Can Trigger Off EB	X		X	X		X	X			X		
Cost Estim. Avail.		X		X	X	X	X	X	X	X	X	
Other												X
Work Search or Train. Req.												
Other Elig. Req.												X

Table 1
Characteristics of Bills Affecting Extended Benefits, Emergency Benefits, and Supplemental Compensation (continued)

Year	1992							1993			
Congress	102nd, 2nd							103rd, 1st			
Bill	H.R. 4351	H.R. 4727	H.R. 5260	S. 2164	S. 2173	S. 2291	S. 2699	H.R. 920	H.R. 3074	H.R. 3167	S. 382
Purpose											
Replaced EB											
Modified or Extended EB	X	X	X			X					
Modified Emergency Benefits	X	X	X	X	X	X	X	X	X	X	X
National Triggers			X								
State Triggers		X	X								
IUR											
AIUR											
SIUR											
TUR											
STUR		X	X								
XR											
Thresholds		X	X								
Substate Triggers											
SIUR											
STUR											
TUR											
Duration		X	X	X	X		X				
Fixed		X	X								
Based on Econ. Cond.		X	X	X	X		X				
Financing		X	X		X		X	X			X
FUTA Tax		X									
Wage Base		X									
EUCA Ceiling		X	X								
Borrow from Other Unemp. Accounts		X	X				X	X			X
Auth. Approp. for Admin.											
100% Fed. Financed		X	X				X				
Borrow from General Fund											
Flow of Funds		X	X								
Income Taxes on UI Benefits		X									
EUC Provisions		X	X		X		X	X	X	X	X
Reachback											
Start Date		10/1	3/6		E		E	3/6	10/2	10/2	3/6
End Date			6/19		7/4		3/6	10/2	6/30	2/5	10/2
Can Trigger Off EB											
Cost Estim. Avail.		X	X		X		X	X		X	X
Other	X	X	X			X				X	
Work Search or Train. Req.		X	X								
Other Elig. Req.	X	X	X			X				X	

End Notes

1. For a description of the complex Federal work-search requirements, see the report to the Advisory Council on Unemployment Compensation by A. Brinsko. 1993. *The Work Search Test Under Extended Benefits.* 1-2.

2. H.R. 3755, H.R. 5846, and S. 2143 from the 102nd Congress were not reviewed because we were unable to obtain copies of the proposed bills.

Appendix

Summaries of Proposed Legislation

Guide for Reading Bill Summaries

Each bill summary contains the following categories. Except where self-explanatory, the categories are as follows:

Congress	
Year	
Bill Number	
Purpose	Purpose as listed on the bill.
Sponsor	
National Trigger	
Minimum Period	Minimum period that the Extended Benefit program must stay on in a given State, once it has triggered on.
State Trigger	Describes relevant trigger mechanisms, trigger levels, thresholds, and the corresponding benefit durations for States.
Substate Eligibility	
Substate Trigger	
Effective Dates	Effective dates for a given program (usually written in the form: start date - end date).
Reachback Provisions	Date to which reachback provisions are effective.
Applicable Limit	Describes whether the benefit duration period for an individual can increase, if the applicable limit for a benefit duration period in a State increases.
Financing	Contains various financing mechanisms that directly influence the Unemployment Insurance program. Not listed are offsetting revenue provisions that only affect the UI program through the General Fund.
Cost Estimate	This category contains gross cost estimates (i.e., offsetting revenues are not included because the range of funding options makes it more difficult to compare bills). Estimates were prepared by the Congressional Budget Office.
Other (Optional)	Only some summaries contain this category. Provisions in this category usually relate to eligibility requirements.
Comment	Lists related bills and notes which bills were signed into law.

Bills are listed in chronological order by year and house (e.g., House bills from 1989 are followed by Senate bills from 1989, which are followed by House bills from 1990...).

Parentheses after the different triggering mechanisms (e.g., AIUR, IUR) indicate the number of weeks (w) or months (m) used in calculating the appropriate average.

Congress	101st 1st Session
Year	1989
Bill Number	H.R. 2425
Purpose	A bill to provide an improved program of extended unemployment compensation and other purposes.
Sponsor	Pease
National Trigger	n.a.
Minimum Period	3 months

State Trigger

Triggers evaluated at the beginning of every quarter. Eligible recipients are eligible to receive the lesser of

116 percent of their regular UI benefits **OR**

30 weeks when SIUR(13w) ≥ 8% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR STUR of 2 months prior ≥ 13 %
OR avg. TUR of the previous year & that of current month ≥ 13%

25 weeks when SIUR(13w) ≥ 7% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR SIUR(13w) ≥ 8%
OR STUR of 2 months prior ≥ 12 %
OR avg. TUR of the previous year & that of current month ≥ 12%

20 weeks when SIUR(13w) ≥ 6% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR SIUR(13w) ≥ 7%
OR STUR of 2 months prior ≥ 11 %
OR avg. TUR of the previous year & that of current month ≥ 11%

15 weeks when SIUR(13w) ≥ 5% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR SIUR(13w) ≥ 6%
OR STUR of 2 months prior ≥ 10 %
OR avg. TUR of the previous year & that of current month ≥ 10%

10 weeks when SIUR(13w) ≥ 7% **and** SIUR(13w) ≥ 130% of avg. in prev. 6 years
OR SIUR(13w) ≥ 5%
OR STUR of 2 months prior ≥ 9 %
OR avg. TUR of the previous year & that of current month ≥ 9%

Substate Eligibility

Establishes demonstration projects using substate triggers in at least 5 states. Individuals whose last place of employment was in a substate area that has triggered on are eligible for benefits.

Substate Trigger

30 weeks when SIUR(13w) ≥ 9% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR STUR of 2 months prior ≥ 14 %
OR avg. TUR of the previous year & that of current month ≥ 14%

25 weeks when SIUR(13w) ≥ 8% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR SIUR(13w) ≥ 9%
OR STUR of 2 months prior ≥ 13 %
OR avg. TUR of the previous year & that of current month ≥ 13%

20 weeks when SIUR(13w) ≥ 7% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years
OR SIUR(13w) ≥ 8%
OR STUR of 2 months prior ≥ 12 %
OR avg. TUR of the previous year & that of current month ≥ 12%

15 weeks when SIUR(13w) ≥ 6% **and** SIUR(13w) ≥ 105% of avg. in prev. 6 years

		OR SIUR(13w) ≥ 7%
		OR STUR of 2 months prior ≥ 11 %
		OR avg. TUR of the previous year & that of current month ≥ 11%
	10 weeks when	SIUR(13w) ≥ 7% **and** SIUR(13w) ≥ 130% of avg. in prev. 6 years
		OR SIUR(13w) ≥ 6%
		OR STUR of 2 months prior ≥ 10 %
		OR avg. TUR of the previous year & that of current month ≥ 10%

Effective Dates January 1, 1990, or June 1, 1990

Reachback Provisions n.a.

Applicable Limit Subsequent changes in the time limit do not change a recipient's benefits.

Financing The Federal Govt. will finance

90% of the associated costs when recipients are eligible for	30 weeks of EB
80	25
70	20
60	15
50	10

100% of these funds may be appropriated if recipients are elig. for 30 weeks of EB

75	25
50	20
25	15

Cost Estimate n.a.

Comment n.a.

Congress	101st 1st Session
Year	1989
Bill Number	H.R. 2478
Purpose	A bill to permit States to use an indicator based on exhaustion rates for purposes of determining whether extended unemployment benefits are payable.
Sponsor	Levin
National Trigger	n.a.
Minimum Period	n.a
State Trigger	Revises the EB triggers. EB triggered on when IUR(13w) ≥ 105% of avg. in prev. 2 years **and** IUR(13w) ≥ 5% **OR** IUR(13w) ≥ 6 % (at State's discretion) **OR** XR (13w) ≥ 110% of the avg. weekly rate of the State's XR between 1948 and the most recent year for which data is avail. **and** IUR(13w) ≥ 3%
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	n.a.
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	n.a.
Cost Estimate	n.a.
Comments	n.a.

Congress 101st 2nd Session

Year 1990

Bill Number H.R. 3896

Purpose A bill to revise the trigger provisions in the Extended Unemployment Compensation program and for other purposes.

Sponsor Pease

National Trigger n.a.

Minimum Period n.a.

State Trigger EB is triggered on when
IUR(13w) ≥ 4% **and** IUR(13w) ≥ 120% of avg. in prev. 2 years
OR TUR in prior year ≥ 8 %
OR IUR ≥ 5%

Substate Eligibility Individuals who live in **or** whose last place of employment was in a substate area that has triggered on are eligible for benefits.

Substate Trigger EB is triggered on the third week after a trigger is on for a week. The trigger is TUR(12m) ≥ 8% **and** the Governor declares the area eligible for EB.

Effective Dates n.a.

Reachback Provisions n.a.

Applicable Limit n.a.

Financing Increases the taxable wage base to $ 8,000 in CY 1991
$ 9,000 in CY 1992
$10,000 in CY 1993
by a given formula in subsequent years

Increases the ceiling in the EUCA to 0.625% of total annual wages. Increases ESAA payout to $3 billion and indexes it to the increase in the average annual wage.

Cost Estimate

Year	Extended Benefits Program	Administration
1991	$ 320 million	$ 0 million
1992	320	360
1993	320	410
1994	320	460
1995	320	520
Total	**$1,600 million**	**$1,750** million

Other Requires EB recipients to participate in training programs.

Comment n.a.

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 914
Purpose	A bill to provide an improved program of extended unemployment compensation and other purposes.
Sponsor	Pease
National Trigger	n.a.
Minimum Period	Same as H.R. 2425
State Trigger	Same as H.R. 2425
Substate Eligibility	Same as H.R. 2425
Substate Trigger	Same as H.R. 2425
Effective Dates	Same as H.R. 2425
Reachback Provisions	Same as H.R. 2425
Applicable Limit	Same as H.R. 2425
Financing	Same as H.R. 2425
Cost Estimate	Same as H.R. 2425
Comments	Same as H.R. 2425

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 1367
Purpose	A bill to provide a program of Federal supplemental compensation and for other purposes.
Sponsor	Downey
National Trigger	Temporary National Trigger established to determine whether State is in a Supplemental Benefit Period for weeks before 10/92 (see below) Program triggered on if national STUR(3m) ≥ 6% **OR** if national TUR(6m) ≥ 6% (if STUR data not available)
Minimum Period	See below
State Trigger	Establishes two levels of triggers. First, Federal Supplemental Compensation benefits are triggered on and off on a weekly basis. Triggers must be "on" for 1 month before benefits can be claimed. The first level of triggers are 26 weeks when STUR(3m) ≥ 8% 18 weeks when STUR(3m) ≥ 7% 9 weeks when STUR(3m) ≥ 6% Second, "Supplemental Benefit Periods" (SBPs) are driven by indicators that are turned on and off on a monthly basis. Each SBP must be at least 3 months long and must be separated from another SBP by 3 months. During these periods, individuals are eligible to receive supplemental benefits for the entire SBP up to a total of 26 weeks. The indicators are STUR(3m) ≥ 6% **AND** **EITHER** 1) STUR(3m) ≥ 120% of avg. in previous 2 years **OR** 2) the national STUR(3m) ≥ 6% **OR** prior to 10/92, the national trigger (as described above) is on.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	SBPs may begin 2 months after enactment.
Reachback Provisions	December 31, 1990
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed with funds from the supplemental compensation account, which replaces the EUCA. Authorizes borrowing between Federal unemployment accounts. Provides incentives to State solvency through increased administrative financing. Raises the Federal taxable wage base to the Social Security maximum. Reduces the Federal unemployment tax to

0.75% in 1992
0.60% in 1993
0.55% in 1994
0.40% in 1995
0.35% in 1996
0.30% thereafter

Cost Estimate

Year	Extended Benefits Program	Administration
1991	$ 2,695 million	$ 0 million
1992	5,025	760
1993	2,885	775
1994	2,200	950
1995	305	810
1996	0	1,010
Total	**$13,110 million**	**$1,750** million

Other

Limited disqualification for benefits to 10 weeks, except for fraud, misconduct, and disqualifying income.

Comments

n.a.

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 1518
Purpose	A bill to provide a program of Federal supplemental compensation.
Sponsor	Mink
National Trigger	n.a.
Minimum Period	3 months separated by periods of 3 months
State Trigger	Federal Supplemental Compensation benefits are triggered on and off on a weekly basis. Triggers must be "on" for 1 month before benefits can be claimed. The trigger is 26 weeks when TUR(3m) $\geq$ 6%
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	FSC benefits start 2 months after enactment. EUC repealed the month after enactment.
Reachback Provisions	None
Applicable Limit	n.a.
Financing	100% Federally financed with funds transferred from the supplemental compensation account, which replaces the EUCA.
Cost Estimate	n.a.
Comment	A very simplified version of H.R. 1367

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 2839
Purpose	A bill to provide a program of Federal supplemental compensation and for other purposes.
Sponsor	Downey
National Trigger	Temporary National Trigger established to determine whether State is in a Supplemental Benefit Period for weeks before 10/92 (see below). Program triggered on if national STUR(3m) ≥ 6% **OR** if national TUR(6m) ≥ 6% (if STUR data not available)
Minimum Period	See below
State Trigger	Establishes two levels of triggers. First, Federal Supplemental Compensation benefits are triggered on and off on a weekly basis. Triggers must be "on" for 1 month before benefits can be claimed. The first level of triggers are 20 weeks when STUR(3m) ≥ 8% 15 weeks when STUR(3m) ≥ 7% 10 weeks when STUR(3m) ≥ 6% Second, "Supplemental Benefit Periods" (SBPs) are driven by indicators that are turned on and off on a monthly basis. Each SBP must be at least 3 months long and must be separated from another SBP by 3 months. During these periods, individuals are eligible to receive supplemental benefits for the entire SBP up to a total of 26 weeks and for at least 10 weeks, if the SBP period ends. The indicators are STUR(3m) ≥ 6% **and** STUR(3m) ≥ 120% of avg. in previous 2 years **OR** prior to 10/92, the national trigger (as described above) is on.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	SBPs may begin 2 months after enactment.
Reachback Provisions	December 31, 1990
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed with funds from the supplemental compensation account, which replaces the EUCA. Provides for appropriations from the General Fund to cover any benefit shortfall. Authorizes borrowing between accounts in the Federal Unemployment Trust Fund. Provides incentives to State solvency through increased administrative financing. Raises the Federal taxable wage base to the Social Security maximum. Transfers income taxes on UI benefits to the Federal Unemployment Trust Fund.

Reduces the Federal unemployment tax to
0.40% in 1993
0.40% in 1994
0.30% in 1995
0.26% in 1996
0.20% thereafter

The ceiling on the Supplemental Compensation Account is raised to 0.625 percent.

Cost Estimate

Year	Federal Supplemental Compensation		Administration	
1991	$ 1,610	million	$ 55	million
1992	3,840		131	
1993	275		10	
1994	0		0	
1995	0		0	
1996	0		0	
Total	**$5,725**	**million**	**$ 195**	**million**

Comment

Similar to H.R. 1367

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3040
Purpose	A bill to provide a program of Federal supplemental compensation and for other purposes.
Sponsor	Rostenkowski
National Trigger	Temporary National Trigger established for determining whether State is in a Supplemental Benefit Period for weeks before 10/92 (see below). Program triggered on if national STUR(3m) ≥ 6% **OR** if national TUR(6m) ≥ 6% (if STUR data not available)
Minimum Period	See below
State Trigger	Establishes two levels of triggers. First, Federal Supplemental Compensation benefits are triggered on and off on a weekly basis. Triggers must be "on" for 1 month before benefits can be claimed. The first level of triggers are 20 weeks when STUR(3m) ≥ 8% 15 weeks when STUR(3m) ≥ 7% 10 weeks when STUR(3m) ≥ 6% 5 weeks when triggered on using the national triggers, only Second, "Supplemental Benefit Periods" (SBPs) are driven by indicators that are turned on and off on a monthly basis. Each SBP must be at least 3 months long and must be separated from another SBP by 3 months. During these periods, individuals are eligible to receive supplemental benefits for the entire SBP up to a total of 26 weeks . The indicators are STUR(3m) ≥ 6% **AND** STUR(3m) ≥ 120% of avg. in previous 2 years **OR** prior to 10/92, the national trigger (as described above) is on.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	SBPs may begin 2 months after enactment.
Reachback Provisions	December 31, 1990
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits. 100% Federally financed with funds from the supplemental compensation account, which replaces the EUCA. Authorizes borrowing between accounts in the Federal Unemployment Trust Fund. Provides incentives to State solvency through increased administrative financing. Provides for appropriations from the General Fund to cover any benefit shortfall. Transfers income taxes on UI benefits to the Federal Unemployment Trust Fund.

Reduces the Federal unemployment tax to
0.40% in 1993
0.40% in 1994
0.30% in 1995
0.26% in 1996
0.20% thereafter

The ceiling on the Supplemental Compensation Account is raised to 0.625 percent.

Cost Estimates

Year	Emergency Unemployment Compensation	Administration
1991	$1,610 million	$ 55 million
1992	3,840	130
1993	275	10
1994	0	0
1995	0	0
1996	0	0
Total	**$5,725 million**	**$195 million**

Comments

Similar to H.R. 1367 and H.R. 2839

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3175
Purpose	A bill to provide emergency unemployment compensation and for other purposes.
Sponsor	Geren
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for 20 weeks when TUR(6m) $\geq$ 8% 13 weeks when TUR(6m) $\geq$ 7% 7 weeks when TUR(6m) $\geq$ 6% 4 weeks when TUR(6m) $<$ 6% Governor also may elect to trigger extended benefits off if the TUR(6m) $\geq$ 7% in order to provide emergency benefits. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	October 6, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	March 31, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	Financed out of the EUCA. Authorizes appropriations for the costs of administration.
Cost Estimates	n.a.
Comments	n.a.

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3201
Purpose	A bill to provide emergency unemployment compensation and for other purposes.
Sponsor	Rostenkowski
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for 20 weeks when TUR(6m) ≥ 8% 13 weeks when TUR(6m) ≥ 7% 7 weeks when TUR ≥ 6% 4 weeks when TUR < 6% The number of eligible weeks are reduced by the number of weeks of EB received. Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	September 1, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	March 31, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	Financed out of the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimates

Year	Emergency Unemployment Compensation		Administration	
1991	$770	million	$ 25	million
1992	4,360		150	
1993	0		0	
1994	0		0	
1995	0		0	
1996	0		0	
Total	**$5,130**	**million**	**$175**	**million**

Comments

Similar to H.R. 3175

Enacted as P.L. 102-107, the *Emergency Unemployment Compensation Act of 1991* on August 17, 1991. The law did not take effect, however, because the President did not declare an emergency.

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3400
Purpose	A bill to provide emergency unemployment compensation.
Sponsor	Michel
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 3 weeks after the trigger is on for a given week. Eligible recipients may receive benefits for 10 weeks when AIUR(13w) ≥ 5% 6 weeks when AIUR(13w) < 5% The number of eligible weeks is reduced by the number of weeks of EB received.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	October 1, 1991 (or the week after bill passed) - June 30, 1992
Reachback Provisions	March 31, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	Financed using funds in the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimates

Year	Emergency Unemployment Compensation	Administration
1992	$ 2,400 million	$80 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$2,400 million**	**$80 million**

Comments Similar to H.R. 3600

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3575
Purpose	A bill to provide a program of Federal supplemental compensation and for other purposes.
Sponsor	Rostenkowski
National Trigger	n.a.
Minimum Period	13 weeks

State Trigger

Federal Supplemental Compensation benefits are triggered on the second week after a trigger is on in a given month. Eligible recipients may receive benefits for up to

13 weeks when TUR(6m) ≥ 7%
7 weeks when TUR(6m) ≥ 6% (or TUR < 6%)

The number of eligible weeks is reduced by the number of weeks of EB received.

Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits.

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates November 3, 1991 (or the week after bill passed) - July 4, 1992

Reachback Provisions February 28, 1991

Applicable Limit Subsequent increases in the time limit increase a recipient's benefits.

Financing 100% Federally financed using funds in the EUCA. Extends the FUTA surtax one year. Provides for appropriations from the General Fund to cover any benefit shortfall.

Cost Estimates

Year	Emergency Unemployment Compensation	Administration
1992	$ 4,390 million	$155 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$4,390 million**	**$155 million**

Comments Initial version of H.R. 3575. Replaced by H.R. 3757 which became the final version of H.R. 3575 and was subsequently enacted as P.L. 102-164 (see below).

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3588
Purpose	A bill to provide emergency unemployment compensation on a pay-as-you-go basis.
Sponsor	Taylor
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for 20 weeks when TUR(6m) ≥ 8% 13 weeks when TUR(6m) ≥ 7% 7 weeks when TUR(6m) ≥ 6% (or when TUR(6m) < 6%) The number of eligible weeks is reduced by the number of weeks of EB received. Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	The day after signed into law (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed using funds in the EUCA.
Cost Estimate	n.a.
Comments	Similar to H.R. 3175 and H.R. 3201

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3600
Purpose	A bill to provide a temporary emergency unemployment compensation program.
Sponsor	Michel
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 3 weeks after the trigger is on for a given week. Eligible recipients may receive benefits for 10 weeks when AIUR(13w) $\geq$ 5% 6 weeks when AIUR(13w) < 5% The number of eligible weeks is reduced by the number of weeks of EB received. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	November 3, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed using funds in the EUCA. Authorizes appropriations for administrative costs.

Cost Estimates

Year	Emergency Unemployment Compensation	Administration
1992	$2,150 million	$ 0 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$2,150 million**	**$ 0 million**

Comments Similar to H.R. 3400

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3618
Purpose	A bill to provide a program of Federal supplemental compensation and for other purposes.
Sponsor	Gilchrest
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Triggers on 1 week after the trigger has been on for a month. 13 weeks when TUR(6m) ≥ 7% 7 weeks when TUR(6m) ≥ 6% (or when TUR(6m) < 6%) The number of eligible weeks is reduced by the number of weeks of EB received. Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	November 3, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991. States that would have triggered on in the weeks following either August 31, 1991, or October 5, 1991, also are eligible for reachback provisions.
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	Financed out of the EUCA. Authorizes appropriations for administrative costs.
Cost Estimate	n.a.
Comments	Similar to H.R. 3175 and H.R. 3201

Congress	102nd 1st Session
Year	1991
Bill Number	H.R. 3757
Purpose	A bill to provide a program of emergency unemployment compensation and for other purposes.
Sponsor	Rostenkowski
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 3 weeks after the trigger is on for a given week. Eligible recipients may receive benefits for 20 weeks when AIUR(13w) ≥ 5% **OR** TUR(6m) ≥ 9% 13 weeks when AIUR(13w) ≥ 4% **OR** AIUR(13w) ≥ 2.5% **AND** XR(1m) ≥ 29% 6 weeks if neither of the above conditions exist For the first week only, the trigger for receiving benefits also may be evaluated using data from the week ending October 19, 1991, and the exhaustion rate is calculated using the 8-month period ending in Sept. 1991; the avg. number of individuals filing claims is calculated using the 8-month period ending in March 1991. The number of eligible weeks is reduced by the number of weeks of EB received. Governor also may elect to trigger extended benefits off if the AIUR(13w) ≥ 4% **OR** AIUR(13w) ≥ 2.5% **AND** XR(1m) ≥ 29% in order to provide emergency benefits. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	November 17, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991. If the AIUR(13w) ≥ 3% for the period ending October 19, 1991, eligible recipients may receive 6 weeks of benefits.
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.

Financing

100% Federally financed out of the EUCA. Authorizes appropriations for administrative costs.
Extends FUTA surtax for an additional year.

Cost Estimates

Year	Emergency Unemployment Compensation		Administration	
1992	$4,645	million	$160	million
1993	0		0	
1994	0		0	
1995	0		0	
1996	0		0	
Total	**$4,645**	**million**	**$160**	**million**

Comments

Replaced initial version of H.R. 3575. Enacted as P.L. 102-164, the "Emergency Compensation Act of 1991" on November 15, 1991.

Congress	102nd 1st Session
Year	1991
Bill Number	S. 1296
Purpose	A bill to provide an optional program for supplemental unemployment compensation and for other purposes.
Sponsor	Riegle
National Trigger	n.a.
Minimum Period	26 weeks, separated by 4 weeks
State Trigger	I. Benefits under the Optional Supplemental Unemployment Benefits program (OSUB) triggers on 3 weeks after a week in which the trigger has been turned on. Eligible recipients may receive benefits for 26 weeks when STUR(3m) ≥ 9% **AND** STUR(3m) ≥ 120% of avg. in previous 2 years 20 weeks when STUR(3m) ≥ 8% **AND** STUR(3m) ≥ 120% of avg. in previous 2 years 13 weeks when STUR(3m) ≥ 7% **AND** STUR(3m) ≥ 120% of avg. in previous 2 years 7 weeks when STUR(3m) ≥ 6% **AND** the national STUR(3m) ≥ 7% Eligible recipients may receive emergency benefits only up to the 26th week, after which their regular UI benefits expire. II. Revises the State triggers under the EB program so that eligible recipients receive benefits when STUR(3m) ≥ 7% **AND** STUR(3m) ≥ 120% of avg. in previous 2 years **OR** the national STUR(3m) ≥ 8%.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	(OSUB) Effective for 1 year beginning 2 months after bill passed or enacted. (EB) January 1, 1994
Reachback Provisions	(OSUB) December 31, 1990
Applicable Limit	(OSUB) Subsequent increases in the time limit increase a recipient's benefits.
Financing	(OSUB) 100% Federally financed out of the EUCA. Authorizes appropriations to carry out program. Adds a contingency fund for costs of administration during periods of high unemployment.

Cost Estimate	Year	Supplemental Unemployment Benefits		Administration	
	1992	$ 2,670	million	$ 0	million
	1993	220		0	
	1994	205		0	
	1995	175		0	
	1996	120		0	
	Total	**$ 3,390**	**million**	**$ 0**	**million**

Comments n.a.

Congress 102nd 1st Session

Year 1991

Bill Number S. 1554

Purpose A bill to provide emergency unemployment compensation and for other purposes.

Sponsor Bentsen

National Trigger n.a.

Minimum Period 13 weeks

State Trigger Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for

20 weeks when TUR(6m) ≥ 8%
13 weeks when TUR(6m) ≥ 7%
7 weeks when TUR(6m) ≥ 6%
4 weeks when TUR(6m) < 6%

The number of eligible weeks is reduced by the number of weeks of EB received.

Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits.

Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates October 6, 1991 (or the week after bill passed) - July 4, 1992

Reachback Provisions March 31, 1991

Applicable Limit Subsequent increases in the time limit increase a recipient's benefits.

Financing Financed out of the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimate

Year	Supplemental Unemployment Benefits		Administration	
1991	$ 0	million	$ 0	million
1992	5,150		175	
1993	0		0	
1994	0		0	
1995	0		0	
1996	0		0	
Total	**$ 5,150**	**million**	**$175**	**million**

Comments Similar to H.R. 3201

Congress 102nd 1st Session
Year 1991
Bill Number S. 1722
Purpose A bill to provide emergency unemployment compensation and for other purposes.
Sponsor Bentsen
National Trigger n.a.
Minimum Period 13 weeks
State Trigger Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for

20 weeks when TUR(6m) ≥ 8%
13 weeks when TUR(6m) ≥ 7%
7 weeks when TUR(6m) ≥ 6%
4 weeks when TUR(6m) < 6%

The number of eligible weeks is reduced by the number of weeks of EB received.

Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits.

Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates October 6, 1991 (or the week after bill passed) - July 4, 1992

Reachback Provisions March 31, 1991

Applicable Limit Subsequent increases in the time limit increase a recipient's benefits.

Financing 100% Federally financed out of the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$ 5,815 million	$ 185 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$ 5,815 million**	**$ 185 million**

Comments Related provisions the same as S. 1554. Vetoed by the President on October 11, 1991.

Congress	102nd 1st Session
Year	1991
Bill Number	S. 1789
Purpose	A bill to provide emergency unemployment compensation and for other purposes.
Sponsor	Durenberger
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 3 weeks after the trigger is on for a given week. Eligible recipients may receive benefits for 15 weeks when AIUR(13w) ≥ 5% 8 weeks when AIUR(13w) < 5% The number of eligible weeks is reduced by the number of weeks of EB received. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	October 6, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed out of the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimate	Year	Emergency Unemployment Compensation	Administration
	1992	$ 3,205 million	$ 110 million
	1993	0	0
	1994	0	0
	1995	0	0
	1996	0	0
	Total	**$ 3,205 million**	**$ 110 million**

Comments Similar to H.R. 3400 and H.R. 3600

Congress	102nd 1st Session
Year	1991
Bill Number	S. 1791
Purpose	A bill to provide emergency unemployment compensation and for other purposes.
Sponsor	Dole
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Emergency benefits trigger on 3 weeks after the trigger is on for a given week. Eligible recipients may receive benefits for 10 weeks when AIUR(13w) $\geq$ 5% 6 weeks when AIUR(13w) < 5% The number of eligible weeks is reduced by the number of weeks of EB received. Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	October 6, 1991 (or the week after bill passed) - July 4, 1992
Reachback Provisions	February 28, 1991
Applicable Limit	Subsequent increases in the time limit increase a recipient's benefits.
Financing	100% Federally financed out of the EUCA. Authorizes appropriations for the costs of administration.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$ 2,420 million	$ 80 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$ 2,420 million**	**$ 80 million**

Comments Similar to S. 1789

Congress 102nd 1st Session

Year 1991

Bill Number S. 1945

Purpose A bill to provide a program of emergency unemployment compensation and for other purposes.

Sponsor Mitchell

National Trigger n.a.

Minimum Period 13 weeks

State Trigger Emergency benefits trigger on 1 week after the trigger is on for a given month. Eligible recipients may receive benefits for

20 weeks when TUR(6m) ≥ 8%
13 weeks when TUR(6m) ≥ 7%
7 weeks when TUR(6m) ≥ 6% (or when TUR(6m) < 6%)

The number of eligible weeks is reduced by the number of weeks of EB received.

Governor also may elect to trigger extended benefits off if the TUR(6m) ≥ 7% in order to provide emergency benefits.

Eligible recipients may receive emergency benefits only up to the 39th week, after which their regular UI benefits expire.

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates November 17, 1991 (or the week after bill passed) - August 1, 1992

Reachback Provisions February 28, 1991. States that would have triggered on in the weeks following either August 31, 1991, or October 5, 1991, also are eligible for reachback provisions.

Applicable Limit Subsequent increases in the time limit increase a recipient's benefits.

Financing 100% Federally financed out of the EUCA. Authorizes appropriations for the costs of administration. Provides for appropriations from the General Fund to cover any benefit shortfall.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$ 4,725 million	$ 0 million
1993	0	0
1994	0	0
1995	0	0
1996	0	0
Total	**$ 4,725 million**	**$ 0 million**

Comments n.a.

Congress 102nd 2nd Session

Year 1992

Bill Number H.R. 4095

Purpose A bill to increase the number of weeks for which benefits are payable under the *Emergency Unemployment Compensation Act of 1991* and for other purposes.

Sponsor Rostenkowski

National Trigger n.a.

Minimum Period 13 weeks

State Trigger Increases the number of weeks an eligible recipient can receive benefits prior to June 13, 1992, to

33 weeks when the State is in a high unemployment period
26 weeks when the State is not in a high unemployment period

After June 13, 1992, the number of weeks an eligible recipient can receive benefits reverts to

20 weeks when the State is in a high unemployment period
13 weeks when the State is not in a high unemployment period

Where a high unemployment period exists if
AIUR(13w)≥5% **OR** TUR(6m)≥9%

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates Date of enactment-July 4, 1992

Reachback Provisions n.a.

Applicable Limit n.a.

Financing Extends the deadline for the payment of additional FUTA taxes in credit reduction States until June 30, 1992, without penalty, but with interest accruing.

Cost Estimate

Year	Emergency Unemployment Compensation		Administration	
1992	$ 2,600	million	$100	million
1993	0		*	
1994	0		0	
1995	0		0	
1996	0		0	
Total	**$ 3,200**	**million**	**$100**	**million**

* less than 50 million

Comments Enacted as P.L. 102-244 on February 7, 1992.

Congress	102nd 2nd Session
Year	1992
Bill Number	H.R. 4227
Purpose	A bill to provide that the eligibility requirements applicable to regular unemployment compensation benefits shall apply in determining eligibility for regular emergency unemployment compensation benefits.
Sponsor	Lehman
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	Date of enactment
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	n.a.
Cost Estimate	n.a.
Other	Changes eligibility requirements for emergency benefits to those used for determining eligibility for regular unemployment benefits, not extended unemployment benefits.
Comments	n.a.

Congress	102nd 2nd Session
Year	1992
Bill Number	H.R. 4351
Purpose	A bill to revise the eligibility requirements applicable to emergency and extended unemployment compensation benefits.
Sponsor	Thomas
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	Date of enactment
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	n.a.
Cost Estimate	n.a.
Other	?
Comments	Same as S. 2291.

Congress	102nd 2nd Session
Year	1992
Bill Number	H.R. 4727 (version as changed in Committee)
Purpose	A bill to extend the Emergency Unemployment Compensation program, to revise the trigger provisions contained in the Extended Unemployment Compensation program, and for other purposes.
Sponsor	Downey
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	(Emergency) Reduces benefits that an eligible recipient can receive after June 13, 1992 to the lesser of 100% of the recipient's regular UI benefits **OR** 26 weeks when the State is in a high unemployment period 20 weeks when the State is not in a high unemployment period Reduces benefits that an eligible recipient can receive after December 31, 1992, to the lesser of 50% of the recipient's regular UI benefits **OR** 13 weeks when the State is in a high unemployment period 10 weeks when the State is not in a high unemployment period (Extended Benefits) Benefits trigger on after the trigger has been on for a month. The new triggers are STUR(3m) ≥ 6% **AND** STUR(3m) ≥ 110% of the avg. in the 2 prev. years In periods where STUR(3m) ≥ 8% **AND** STUR(3m) ≥ 110% of avg. in prev. 2 years, eligible recipients may receive the lesser of 1) 80% of their regular UI benefits 2) 20 weeks of extended benefits 3) 46 weeks of total unemployment (regular and extended) benefits
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	(Emergency Benefits): Extends program through the earliest of 1) April 1, 1993 2) 3 months after the first month where the national STUR < 6.5% (after 6/92) 3) The first month where the national the national STUR < 6% (after 6/92) (Extended Benefits): October 1, 1993.

Reachback Provisions n.a.

Applicable Limit n.a.

Financing

(Extended) Increases the Federal matching percentage to 75%.
(General) Reduces the FUTA tax to 0.3% between 1993 and 1997 and to 0.25% after 1997. Raises the Federal taxable wage base to the average annual covered wages in employment over the most recent year for which data are available. Separates State taxable wages from Federal taxable wages. Extends the 2-year grace period for unemployment penalty taxes in States with overdue unemployment loans to 3 years, if the State amended its laws in 1992 or 1993 to increase estimated revenues by at least 25% in the yr. after enactment. Transfers income taxes on unemployment benefits to the Unemployment Compensation Trust Fund. Directs the Dept. of Treasury to estimate the amount equal to the income taxes on unemployment benefits that would have been collected between December 31, 1990, and the date of the bill's enactment and transfer these amounts to the Unemployment Compensation Trust Fund. The ceiling on the Supplemental Compensation Account is raised to 0.625 percent of total annual wages after September 30, 1993. Changes the flow of FUTA taxes so that the EUCA receives 20% of the funds. Authorizes borrowing between accounts in the Federal Unemployment Trust Fund.

Other

(Emergency) Amends the EUC program to use State qualification requirements instead of the qualifications under the Federal-State Extended Benefit Program. Allows individuals who exhaust their emergency benefits during the year and who are required to reapply for emergency benefits to continue receiving EUC instead of reapplying for regular benefits.

(Extended) Repeals qualification, disqualification, job search, and reemployment requirements for eligibility. Effective October 1, 1993.

Cost Estimate

Year	Emergency	Admin. (EUC)	Extended	Admin(EB)
1992	$ 950 million	30 million	$ 0 million	0
1993	3,095 105	0	0	
1994	0	0	880	30
1995	0	0	490	20
1996	0	0	115	5
1997	0	0	100	5
Total	**$4,045 million**	**$135 million**	**$100 million**	**$60 million**

Comments Similar to H.R. 5260

Congress	102nd 2nd Session
Year	1992
Bill Number	H.R. 5260 (version that became P.L. 102-318)
Purpose	A bill to extend the Emergency Unemployment Compensation program, to revise the trigger provisions contained in the Extended Unemployment Compensation program, and for other purposes.
Sponsor	Rostenkowski
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	(Emergency) Reduces benefits that an eligible recipient can receive after June 13, 1992, to the lesser of

100% of the recipient's regular UI benefits **OR**

26 weeks when the State is in a high unemployment period
20 weeks when the State is not in a high unemployment period

Reduces benefits that an eligible recipient can receive when 6.8% < national STUR(2m) ≤ 7% to

60% of the recipient's regular UI benefits **OR**

15 weeks when the State is in a high unemployment period
10 weeks when the State is not in a high unemployment period

Reduces benefits that an eligible recipient can receive when the national STUR(2m) < 6.8% to

50% of the recipient's regular UI benefits **OR**

13 weeks when the State is in a high unemployment period
7 weeks when the State is not in a high unemployment period

Prohibits Governors from electing to trigger EB off in favor of EUC after March 6, 1993.

(Extended Benefit Program) Benefits trigger on after the trigger has been on for a month. The new triggers are

National STUR(3m) ≥ 6.5%
AND STUR(3m) ≥ 110% of the avg. in the 2 prev. years

In periods where STUR(3m) ≥ 8% **AND** STUR(3m) ≥ 110% of avg. in prev. 2 years, eligible recipients may receive the lesser of

1) 80% of their regular UI benefits
2) 20 weeks of extended benefits
3) 46 weeks of total unemployment (regular and extended) benefits

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates (Emergency Benefits): Extends program through March 6, 1993 - June 19,1993.

(Extended Benefits): March 6, 1993.

Reachback Provisions n.a.

Applicable Limit n.a.

Financing (Extended) Increases the Federal matching percentage to 75%.
(General) Extends the 2-year grace period for unemployment penalty taxes in States with overdue unemployment loans to 3 years, if the State amended its laws in 1992 or 1993 to increase estimated revenues by at least 25% in the yr. after enactment. The ceiling on the Supplemental Compensation Account is raised to 0.5 percent of total annual wages after September 30, 1993. Changes the flow of FUTA taxes so that the EUCA receives 20% of the funds. Authorizes borrowing between Federal unemployment accounts.

Other (Emergency) Allows individuals who exhaust their emergency benefits during the year and who are required to reapply for emergency benefits to continue receiving EUC instead of reapplying for regular benefits.

(Extended) Repeals qualification, disqualification, job search, and reemployment requirements for eligibility. Effective October 1, 1993.

Cost Estimate

Year	Emergency	Admin. (EUC)	Extended	Admin(EB)
1992	$ 950 million	30 million	$ 0 million	0
1993	3,095	105 0	0	
1994	0	0	880	30
1995	0	0	490	20
1996	0	0	115	5
1997	0	0	100	5
Total	**$44,045 million**	**$135 million**	**$100 million**	**$60 million**

Comments Similar to H.R. 4727; enacted as P.L. 102-318

Congress	102nd 2nd Session
Year	1992
Bill Number	S. 2164
Purpose	A bill to increase the number of weeks for which benefits are payable under the *Emergency Unemployment Compensation Act of 1991* and for other purposes.
Sponsor	Sarbanes
National Trigger	n.a.
Minimum Period	13 weeks
State Trigger	Increases the number of weeks an eligible recipient can receive benefits prior to June 13, 1992 to 33 weeks when the State is in a high unemployment period 26 weeks when the State is not in a high unemployment period After June 13, 1992, the number of weeks an eligible recipient can receive benefits reverts to 20 weeks when the State is in a high unemployment period 13 weeks when the State is not in a high unemployment period
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	?
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	n.a.
Cost Estimate	n.a.
Comments	Similar to S. 2173 and H.R. 4095

Congress 102nd 2nd Session

Year 1992

Bill Number S. 2173 (same as H.R. 4095)

Purpose A bill to increase the number of weeks for which benefits are payable under the *Emergency Unemployment Compensation Act of 1991* and for other purposes.

Sponsor Bentsen

National Trigger n.a.

Minimum Period 13 weeks

State Trigger Increases the number of weeks an eligible recipient can receive benefits prior to June 13, 1992, to

33 weeks when the State is in a high unemployment period
26 weeks when the State is not in a high unemployment period

After June 13, 1992, the number of weeks an eligible recipient can receive benefits reverts to

20 weeks when the State is in a high unemployment period
13 weeks when the State is not in a high unemployment period

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates Date of enactment-July 4, 1992

Reachback Provisions n.a.

Applicable Limit n.a.

Financing Extends the deadline for the payment of additional FUTA taxes in credit reduction States until June 30, 1992, without penalty, but with interest accruing.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$2,600 million	$ 100 million
1993	600	*
1994	0	0
1995	0	0
1996	0	0
1997	0	0
Total	**$3,200 million**	**$ 100 million**

* less than 50 million

Comments H.R. 4095 considered in lieu of this bill; H.R. 4095 enacted as P.L. 102-244

Congress	102nd 2nd Session
Year	1992
Bill Number	S. 2291
Purpose	A bill to revise the eligibility requirements applicable to emergency and extended unemployment compensation benefits.
Sponsor	Seymour
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	Date of enactment
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	n.a.
Cost Estimate	n.a.
Other	?
Comments	Same as H.R. 4351

Congress 102nd 2nd Session

Year 1992

Bill Number S. 2699

Purpose A bill to extend the period for which unemployment benefits are payable under title I of the *Emergency Unemployment Compensation Act of 1991* and for other purposes.

Sponsor Dole

National Trigger n.a.

Minimum Period n.a.

State Trigger Decreases the benefits eligible recipients can receive benefits prior after January 2, 1993, and before March 6, 1993, to the lesser of

40 percent of their regular UI benefits **OR**

10 weeks when the State is in a high unemployment period
7 weeks when the State is not in a high unemployment period

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates Date of enactment-March 6, 1993

Reachback Provisions n.a.

Applicable Limit n.a.

Financing Authorizes repayable advances to the EUCA from the Federal Unemployment Account to carry out program and fund extended benefit program. Advances must be repaid when the balance in the EUCA exceed the amount estimated to fund the next 3 months of payments.

Comments n.a.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$ 635 million	$ 20 million
1993	2,135	75
1994	0	0
1995	0	0
1996	0	0
1997	0	0
Total	**$2,770 million**	**$ 95 million**

Congress	103rd 1st Session
Year	1993
Bill Number	H.R. 920
Purpose	A bill to extend the Emergency Unemployment Compensation program and for other purposes.
Sponsor	Rostenkowski
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	March 6, 1993-October 2, 1993. Eligible recipients receiving benefits on October 2, 1993, may continue to receive benefits until January 15, 1994, as long as they continue to meet the eligibility requirements.
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	Authorizes nonrepayable advances to the EUCA from the Federal Unemployment Account to carry out program.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$3,210 million	$ 110 million
1993	2,340	0
1994	0	0
1995	0	0
1996	0	0
1997	0	0
Total	**$5,550 million**	**$ 110 million**

Comments Enacted as P.L. 103-6; as amended, passed in lieu of S. 382

Congress	103rd 1st Session
Year	1993
Bill Number	H.R. 3074
Purpose	A bill to extend the Emergency Unemployment Compensation program and for other purposes.
Sponsor	Rangel
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	October 2, 1993-June 30, 1994. Eligible recipients receiving benefits on October 2, 1993, may continue to receive benefits until August 15, 1994, as long as they continue to meet the eligibility requirements.
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	?
Cost Estimate	n.a.
Comments	Similar to H.R. 920

Congress 103rd 1st Session

Year 1993

Bill Number H.R. 3167 (based on version as of 11/21/93)

Purpose A bill to extend the Emergency Unemployment Compensation program, to establish a system of worker profiling, and for other purposes.

Sponsor Rostenkowski

National Trigger n.a.

Minimum Period n.a.

State Trigger Reduces benefits that an eligible recipient can receive after October 2, 1993, to the lesser of

50% of the recipient's regular UI benefits **OR**

13 weeks when the State is in a high unemployment period
7 weeks when the State is not in a high unemployment period

Substate Eligibility n.a.

Substate Trigger n.a.

Effective Dates October 2, 1993-February 5, 1994. Eligible recipients receiving benefits on February 5, 1994, may continue to receive benefits until April 30, 1994, as long as they continue to meet the eligibility requirements.

Reachback Provisions n.a.

Applicable Limit n.a.

Financing Changes flow of FUTA taxes so that the EUCA receives 20% of the funds.

Other Repeals disregard of rights to regular compensation.

Cost Estimate

Year	Emergency	Admin
1994	$1,070 million	$30 million
1995	0	
1996	0	
1997	0	
1998		
Total	**$1,070 million**	**$30 million**

Comments Enacted as P.L. 103-152, the *Unemployment Compensation Amendments of 1993* on November 24, 1993.

Congress	103rd 1st Session
Year	1993
Bill Number	S. 382
Purpose	A bill to extend the Emergency Unemployment Compensation program and for other purposes.
Sponsor	Moynihan
National Trigger	n.a.
Minimum Period	n.a.
State Trigger	n.a.
Substate Eligibility	n.a.
Substate Trigger	n.a.
Effective Dates	March 6, 1993-October 2, 1993. Eligible recipients receiving benefits on October 2, 1993, may continue to receive benefits until January 15, 1994, as long as they continue to meet the eligibility requirements.
Reachback Provisions	n.a.
Applicable Limit	n.a.
Financing	Authorizes nonrepayable advances to the EUCA from the Federal Unemployment Account to carry out program.

Cost Estimate

Year	Emergency Unemployment Compensation	Administration
1992	$3,210 million	$ 110 million
1993	2,340	0
1994	0	0
1995	0	0
1996	0	0
1997	0	0
Total	**$5,550 million**	**$ 110 million**

Comments H.R. 920 passed in lieu of S. 382; H.R. 920 enacted as 103-6

FINAL REPORT:

THE INTERACTION BETWEEN UNEMPLOYMENT INSURANCE AND INCOME REDISTRIBUTION PROGRAMS

by

Steven G. Craig

and

Michael G. Palumbo

Department of Economics
University of Houston
Houston, TX 77204-5882
(713)-743-3812
SCraig@uh.edu
Palumbo@uh.edu

ABSTRACT

This report empirically investigates relationships between Unemployment Insurance (UI) and welfare. Programmatic variation is compared using a unique database covering 48 states from 1969-89. Raw data, state specific elements from a panel regression, and a simultaneous model provide evidence on UI and welfare program interaction. Variation in UI benefits is found much smaller than for UI recipiency or welfare outcomes. The simultaneous model finds cash assistance from AFDC substitutes for UI, while states with large UI programs are found to operate large welfare programs overall. Elderly, poor, and families headed by females are associated with larger welfare and lower UI programs.

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I. Introduction

In this paper we investigate relationships between state government provision of Unemployment Insurance (UI) and low income assistance-- welfare. Our primary goal is to understand why states do not have essentially identical eligibility criteria and benefit levels for UI. We document empirically, for the first time, dramatic differences in the structure of UI programs across states, as revealed in measures of benefit and recipiency outcomes. In addition to an extensive vector of economic and demographic variables, we find that variation in welfare program outcomes proves quite informative in describing interstate variation in UI.

Researchers have devoted little attention to interstate variation in UI program design, we believe, because of an underlying presumption that UI operates solely as a public insurance program.[1] Textbook theory justifies intervention into the labor market through mandatory UI coverage as a public solution to an adverse selection problem. Thus, after controlling for economic volatility, little difference between states in the demand for UI would be expected.

Our research shows that such a simple view of UI is untenable. We demonstrate the existence of substantial and persistent variation in UI outcomes across states. This variation is not only apparent in the raw data, but is evident even after controlling for an extensive array of economic and demographic factors. We explore the nature of interstate variation through estimation of a simultaneous model of UI and welfare program outcome determination. Results from this model strongly suggest that state governments are not simply solving a public insurance problem, but that instead there are significant similarities in how UI and welfare programs are designed. Thus variability in UI programs across states can be partially explained by motives similar to those that cause substantial variation in welfare outcomes across states.

UI and low income assistance constitute two distinct components of the "social safety net." While there are reasons to believe that UI and welfare are unrelated, there are also considerable commonalities between the programs that explain why the programs might be interrelated. An important distinction between UI and welfare is that while both programs seek to help those with insufficient

incomes, UI explicitly targets those attached to the labor force. UI generally provides higher benefits to those with higher previous incomes, while welfare receipt requires a means test with benefits inversely correlated with current income. Further, UI is financed by an earmarked tax dedicated to a separate trust fund, while welfare is financed out of general tax revenues.

Despite the unique trust fund that characterizes UI financing, there are important institutional features in common between UI and welfare. UI is operated under a federal umbrella defining the basic structure of the program, but also allowing state governments significant leeway for selecting specific program parameters affecting benefit levels, eligibility standards, and total program expenditures (Advisory Council, 1995; National Foundation, 1992). Two of the most important welfare programs, Aid to Families with Dependent Children (AFDC) and Medicaid, operate under a similar institutional arrangement in that state governments face wide latitude over policy choices within ranges prescribed by the federal government. Further, state governments face similar challenges from UI and welfare in terms of fiscal fungibility. Though UI is financed through a dedicated trust fund, even a moderately sophisticated legislature will recognize the real burdens imposed on workers and firms by UI taxes, and thus will include such burdens when balancing fiscal impacts of alternative policies. Similarly, significant federal aid is mandated to be spent on welfare programs, but state governments have been shown to successfully circumvent federal restrictions on how aid is spent.

Exploiting empirical relationships between UI and low income assistance represents a departure from the small extant literature on motivations affecting state choices in UI program design. Adams (1986) develops and tests a political economy model to ascertain whether interindustry subsidies play a role in determining how states design their programs. Recently, Anderson and Meyer (1993) have presented corroborating evidence that extends to interfirm as well as interindustry cross subsidization, and they show the subsidies have been consistent across time. Implicitly, our research approach differs from these two papers by focusing on the extent to which individual workers are compensated

through their state's UI program, rather than aggregating workers up to the firm or industry level.

Our empirical methodology compares variation in UI to variation in welfare through three stages, using a unique database covering the 48 mainland states over the period 1969-89. First, we examine raw data on expenditures, recipients, and benefits per recipient for UI and for three welfare programs: AFDC, Medicaid, and total state and local low income assistance. Both time series and cross section variation is used to establish that interstate variability in UI recipiency is the primary contributor to between state variability in UI programmatic outcomes.

Second, we analyze state specific elements from a panel regression model while controlling for a wide variety of other potential causes of interstate variability. Estimated state fixed effects imply state policy choice appears to be a central contributor to variability in UI program outcomes. Variability in fixed state effects for UI is generally as large as is estimated for the various welfare programs.

Our third methodology involves estimating a simultaneous model for UI and welfare program outcomes. Estimation results reveal significant programmatic interaction between UI and welfare. In particular, we find UI expenditures substitute for the primary cash assistance welfare program, AFDC. On the other hand, our empirical findings suggest states with generous UI programs are more likely to finance generous combined total welfare. The simultaneous model results also show, using variables measuring the relative strength of welfare program targeted recipient groups, trade offs between UI and welfare consistent with the hypothesis that the policies are interrelated in design.

II. Data Description and Research Methodology

Our empirical analysis of UI and welfare is based on a unique database containing information about policy outcomes for each of the 48 mainland states during the 21 year period 1969-1989.[2] We analyze state policy choices through three central types of outcomes: total annual expenditures per worker (or per

capita for welfare), number of recipients per worker (per capita), and benefits per recipient.[3] All dollar denominated variables are measured in 1989 Alabama dollars using a state level price index. This section first provides specific definitions of the variables used for both UI and welfare. Second, we present the reduced form models used to obtain state fixed effects, and third we present the simultaneous model of UI and welfare program interaction.

A. Unemployment Insurance Variable Definitions

UI information is published by the U.S. Department of Labor (1993). Total UI expenditures can be decomposed into two components: the number of recipients and average benefits per recipient. We examine two different definitions of UI recipients and benefits per recipient so that both sets of definitions have as their product total expenditures. The first definitions correspond to Department of Labor outcome measures, while the second definitions correspond more directly to data available for low income assistance programs.

Our first definition measures UI recipients as the share of total annual weeks worked by covered workers in each state during each year, as follows:

$$(1) \qquad UIWEEKS = \frac{\text{Annual Number of UI Weeks Compensated}}{\text{Number of Covered Workers*52 Weeks per Year}}$$

UIWEEKS is the percentage of potential annual weeks worked by a state's covered workers in which former workers receive UI benefits.

The definition of UI benefits per recipient consistent with UIWEEKS is the average weekly benefit amount, UIAWBA. UIAWBA is the dollar value of average weekly benefits received by compensated, unemployed workers during the year. Under this definition, annual UI expenditures are

$$(2) \qquad UIEXP = UIAWBA * UIWEEKS * 52$$

where UIEXP is real annual UI expenditure per worker. Multiplying UIWEEKS by 52 converts this variable to the annual number of unemployment weeks compensated per worker covered under UI, while UIAWBA is the average weekly benefit received.

Our second set of definitions for the number of UI recipients and benefits

per recipient corresponds to variables available for welfare, because low income assistance data from the states is measured on an annual basis (rather than weekly). Thus an alternative definition for UI recipients is the share of covered workers during the year that receive benefits. The Department of Labor refers to the number of initially eligible recipients each year as the number of first payments. We divide this variable by the number of covered workers in defining UIFIPAY:

$$(3) \quad \text{UIFIPAY} = \frac{\text{number of first payments}}{\text{number of covered workers}}$$

UIFIPAY as defined in (3) is related to our first recipient definition from (1) because UIWEEKS is the number of first payments, UIFIPAY, times the average duration of UI benefits for each initial recipient, UIAVGDUR, as:[4]

$$(4) \quad (\text{UIWEEKS} * 52) = \text{UIFIPAY} * \text{UIAVGDUR}.$$

Using UIFIPAY to measure the number of recipients per covered worker, the appropriate definition of benefits per recipient, UIBEN, is the average annual payments received by initially eligible recipients, so that:

$$(5) \quad \text{UIBEN} = \text{UIEXP/UIFIPAY} = \text{UIAWBA} * \text{UIAVGDUR}.$$

Table 1 reports first and second sample moments for all five UI variables, along with brief descriptions of the variables.

B. Low Income Assistance Program Variable Definitions

UI program outcomes are compared to two specific low income assistance programs, as well as to total combined welfare. The two specific programs are those operated under institutional frameworks similar to UI. AFDC is the primary state operated and controlled cash assistance program, while Medicaid is the primary state operated and controlled in kind transfer program. Established in their current form in 1965, these two programs are similar to UI in that considerable interstate variation is permitted within broad federal guidelines and mandated minimum standards. Total welfare incorporates AFDC and Medicaid,

as well as many other primarily in kind programs, and is defined as combined state and local welfare programs net of state to local government transfers.[5]

As with UI, we examine three policy variables for each of the three welfare programs: real annual program expenditures per capita, total number of recipients per capita and average annual real benefits per recipient. Because benefits per recipient for welfare is measured on an annual basis, it corresponds most closely to UIBEN (annual UI benefits per initial claimant) from equation (5). It follows that the number of welfare recipients corresponds more closely to UIFIPAY than to UIWEEKS, since as shown in (4) we do not have a measure of average duration for welfare recipients.

We use the following abbreviations: AFEXP for annual real AFDC expenditures per capita; AFPOP for number of AFDC recipients per capita; and, AFBEN for average real annual AFDC benefits per recipient. Similarly, the corresponding Medicaid program variables are MCEXP, MCPOP and MCBEN, and total state and local welfare measures are SLEXP, SLPOP and SLBEN. Our measure of recipients for combined state and local spending are AFDC recipients plus non overlap Food Stamp recipients. The Food Stamp program is operated entirely at the Federal level, with local governments serving only an administrative role. Food Stamp eligibility, however, is very widely defined (Craig and Kohlhase, 1985). Eligibility in one welfare program often triggers eligibility for others, so Food Stamp recipients satisfy a rather broad range of eligibility standards. Thus our assumption is that the combination of Food Stamp and AFDC recipients essentially defines the universe of state welfare participants.

As with the UI variables, recipients and benefits per recipient for all three welfare programs are defined so their product is total program expenditure:

$$
\begin{aligned}
&\text{(a)} \quad AFEXP = AFPOP*AFBEN \\
(6)\quad &\text{(b)} \quad MCEXP = MCPOP*MCBEN \\
&\text{(c)} \quad SLEXP = SLPOP*SLBEN.
\end{aligned}
$$

Data on AFEXP, MCEXP and SLEXP are available for each of the 48 mainland states from 1969-89, but data on Medicaid and total state and local welfare

recipients, MCPOP and SLPOP, only exist for 1976 and after.[6] Thus, we analyze all three AFDC program variables (AFEXP, AFPOP, AFBEN), as well as MCEXP and SLEXP during the 21 year period, 1969-1989. Our analysis of MCPOP, MCBEN, SLPOP and SLBEN is restricted to the 14 year period, 1976-1989. Along with UI, summary statistics for the low income assistance data appear in Table 1.

C. Reduced Form Models for the UI Program

Our empirical models are designed to explain variation across states and over time in the level of total UI expenditures per worker, as well as the relative emphases placed on the number of UI recipients per worker and benefits per recipient. Our models are not structural, however, because they are unable to distinguish factors that may affect the demand for insurance from, for example, the ability of a state government to translate that demand into policy action. For example, states whose economies are more prone to cyclical fluctuations might be expected to design different UI programs than states experiencing less variable economic structures. Variables such as industrial composition and population characteristics might be expected to capture such affects. On the other hand, population characteristics and industrial structure might also explain policy tastes affecting UI program design through the political process. Thus the estimated parameters in our reduced form model must be interpreted carefully.

The pooled regression model to explain the UI program outcomes is:

$$(7) \quad \left.\begin{array}{l} \text{UIEXP} \\ \text{UIWEEKS (UIFIPAY)} \\ \text{UIAWBA (UIBEN)} \end{array}\right\} = f(\underline{\text{Demog}}, \underline{\text{Indust}}, \text{LN(UI)}, \underline{\text{S}}, \underline{\text{T}}) .$$

Both sets of UI outcome definitions are used for the analysis. As defined above, UIWEEKS and UIAWBA represent recipients and benefits per recipient using the UI data collection definitions (weekly basis). UIFIPAY and UIBEN are recipients and benefits per recipient corresponding to the welfare program data definitions (annual basis). Demog is a vector of socioeconomic and demographic variables,

and include population, the unemployment rate, the state price index, per capita income, and percent of residents with a high school degree, with a college degree, living in an metropolitan area, in families headed by females, older than sixty four years, living below the poverty line, and who are white. Indust captures each state's industrial composition. This vector contains the state employment shares in each of the 1 digit SIC industries. In addition, the fraction of the workforce belonging to labor unions is included. LN(UI) in (7) represents the average left hand side UI variable of each state's neighbors, lagged one year.[7]

An important attribute of the empirical model is inclusion of fixed effects for states (S) and years (T).[8] The yearly time variables capture any influence common to all states for each year. After controlling for a wide array of observable characteristics included in the Demog and Indust vectors, we interpret the fixed state effects as measuring unexplained UI policy tastes within each state.[9] Each of the five equations is estimated separately by OLS.[10]

D. Reduced Form Models for the Welfare Programs

The reduced form panel regression model used to explain low income assistance across states and over time is due to Craig (1994). Two primary differences exist between the welfare models and the UI models described by (7). First, unlike UI, we do not expect industrial composition to be important for determining state welfare policy, so these variables are omitted. Second, because the level and form of federal aid for low income assistance is important, we include variables capturing federal aid in the welfare regressions.

To be explicit, we estimate three equations by OLS for each of the three welfare programs:

$$(8)\quad \left.\begin{array}{l} \text{AFEXP (MCEXP) (SLEXP)} \\ \text{AFPOP (MCPOP) (SLPOP)} \\ \text{AFBEN (MCBEN) (SLBEN)} \end{array}\right\} = f(\underline{\text{Demog}},\ \underline{\text{AID}},\ \text{LN(Welf)},\ \underline{S},\ \underline{T}\ ) .$$

Each welfare program has as program outcomes expenditure per capita, recipients

per capita, and benefits per recipient (see equation 6). As with the UI model in (7), Demog is the vector of socioeconomic and demographic variables for each state during each year. The Aid vector includes a set of variables describing the federal to state and local aid environment, and includes per capita income. The variable LN(Welf) measures the welfare program outcome on the left hand side of the equation averaged over each state's neighbors, lagged one year (see footnote 8).

As for UI, an important element of our panel regression models is the inclusion of state fixed effects. State fixed effects measure program design elements not captured by the included variables that do not vary across years. A potentially important caveat to our specification is that we do not have data on state level prices for health care, which could be important for explaining variation in Medicaid. The estimating equations also include year fixed effects.

E. The Simultaneous Model of UI and Welfare

In addition to analysis of the raw data and of individual state effects, the third method for ascertaining the relationship between UI and welfare program design is to directly estimate programmatic interaction with a simultaneous model. We do this by expanding the system of equations described in the reduced form models of equations (7) and (8). In particular, we add as an endogenous right hand side variable in the UI regressions of (7) the corresponding welfare variable from (8), and vice versa. For this process we only utilize the UI definitions that correspond to the welfare definitions, which are the UI program outcomes in parentheses in (7).

We compare each UI outcome to each welfare program outcome individually. That is, UI expenditures are compared to each of the three welfare programs individually, as are recipients and benefits per recipient. Thus equations comparing UI and AFDC include expenditure (UIEXP and AFEXP), recipients (UIFIPAY and AFPOP), and benefits per recipient (UIBEN and AFBEN). Similarly, equations comparing UI and Medicaid consist of UIEXP and MCEXP, UIFIPAY and MCPOP, and UIBEN and MCBEN, while for combined state and local welfare they consist of UIEXP

and SLEXP, UIFIPAY and SLPOP, and UIBEN and SLBEN. Thus, we estimate nine simultaneous models, where each model consists of two equations. Each pair of equations is estimated by 3SLS.

We interpret two aspects of the results from the simultaneous estimation process. First, we examine coefficients for the appropriately matched programs for evidence of programmatic interaction. Second, however, is to examine how particular coefficients in the Demog vector perform. Specifically, we identify variables that most closely identify a constituency group for each of the welfare programs. These variables are the percentage of the population in poverty for total welfare, the percentage of families headed by a female for AFDC, and the percentage of the population over 64 years old for Medicaid.

III. Results of the Comparison between UI and Welfare

This section presents the results of our analysis of UI and welfare. In particular, we first examine both the cross sectional differences and the time trends in the raw data to derive a sense of the source of interstate variation in the two types of programs. We also show that the state fixed effects from the regressions in (7) and (8) support the raw data analysis. Finally, we present the results of our simultaneous model of UI and welfare interaction.

A. Time Series and Cross Sectional Variation in UI and Welfare Data

Figures 1-4 provide the basis for comparing patterns over time in state spending for UI, AFDC, Medicaid and total state and local welfare. Each of these four sets of figures depict annual averages of program outcomes across the 48 mainland states. In these graphs, all variables are normalized by their full sample means to facilitate comparisons across programs and types of variables. Thus, every variable in the four figures has an average value (across all years in the sample) of 100: a value of 50 measured along the y axis in the figures represents one half the sample average; a value of 200 represents two times the sample average.

Figure 1 shows two primary features of UI program outcomes during the 1969-

89 period. First, total UI program expenditures, UIEXP (panel A), clearly move contemporaneously with the aggregate unemployment rate (panel G). Peak UI expenditures occur during peak years of unemployment, though factors other than the unemployment rate appear to matter for explaining levels of UIEXP. For example, average total expenditures on unemployment compensation are shown to be largest during 1975, though the 1982-83 recession caused significantly larger rates of unemployment. This data also indicates a more generous UI system during the 1970's than during the 1980's.

The second feature of time series variation in UI expenditures from Figure 1 is that variation in UIEXP (panel A) comes entirely from variation over time in program recipiency rather than program benefits per recipient. Panels B and C, showing UIWEEKS and UIFIPAY respectively, look quite similar to panel A. On the other hand, neither of our variables measuring UI benefits per recipient, average weekly benefits (UIAWBA in panel D) or average annual benefits (UIBEN in panel E) exhibit the time series variability of UIEXP or either measure of recipiency.

Examination of Figures 2-4 shows AFDC, Medicaid and total state and local low income assistance expenditures to vary differently than does UIEXP. None of the welfare program expenditure variables follow aggregate rates of unemployment strongly, neither contemporaneously nor with a short lag. According to Figures 3 and 4, growth in per capita spending on Medicaid and total state and local welfare occurs because of growth in expenditures per recipient (panels C), but not because of an increase in the number of recipients per capita (panels B).[11] In contrast, Figure 2 shows movement in recipients and benefits per recipient to contribute about equally to AFDC expenditure volatility.

Figure 5 initiates our cross state data comparison. The figure presents histograms of 21 year averages (1969 through 1989) of the raw data for each of the UI program variables and the unemployment rate for each of the 48 states under analysis. As before, to allow comparisons of the cross section distributions in UI program outcomes, all variables have been normalized by the full sample means.

Figure 5 reveals the same tendencies with respect to the variability in UI program outcomes across states shown by time series variation in Figure 1. First, as is evidenced in the annual data aggregated over states, the cross section distribution in total UI expenditures per covered worker, UIEXP (panel (A)), is more dispersed than the distribution of unemployment rates across states, UNEMP (panel (G)). Second, the number of unemployment weeks compensated per covered worker during the year, UIWEEKS (panel (B)), shows nearly the same cross section dispersion as total UI expenditures. In contrast, real UI average weekly benefits (UIAWBA, panel (D)) are remarkably similar across states. Average annual UI benefits per worker (UIBEN, panel (E)) shows dampened variability compared to UIEXP, but is more dispersed than UIAWBA. Panel F suggests the greater variability in UIBEN is due to variability in average duration of benefits (UIAVGDUR). Duration, however, is another reflection of eligibility standards, and so we interpret duration as reinforcing our conclusion that interstate variability in UI is due to variation in recipients.

Table 2 tells the same story as Figure 5, using slightly different statistics. The top five rows of Panel A in Table 2 allow comparison across UI program variables, in terms of cross section dispersion, using two summary statistics. The first is the coefficient of variation, which equals the standard deviation of UI variables across states divided by the full sample means (and multiplied by 100). The second summary statistic is the interquartile range for the normalized (by the full sample means) data.

In Figures 6 and 7, the raw data averages are presented in a third way. Figure 6 is a scatterplot of the 21 year averages of the UI average weekly benefit amount (UIAWBA) against the number of unemployment weeks compensated per covered worker (UIWEEKS) for each state. Again, both variables have been normalized by the full sample means to allow easier comparisons between the distributions. Figure 7 is the comparable graph for our alternative UI program variables, UIBEN and UIFIPAY. The advantage of the scatterplot graphs is that a rectangular hyperbole through the points represents total UI expenditure, since total UI expenditure is the product of the variables on each axis.

Figures 6 and 7 illustrate substantial variation in UI expenditures across states, even when averaged for an extended period of time, by showing the relative positions of each of the 48 states in our sample. The Figures also confirm that the primary cause of interstate variation in UI expenditure is recipiency, not benefits pre worker. Washington, the state with the most generous eligibility rules, is shown to compensate three and a half times as many unemployment weeks per covered worker during the 1969 through 1989 period as does Virginia, the least generous state. On the other hand, according to Figure 6, the most generous states in terms of average UI weekly benefits, Michigan and Pennsylvania, spend only about forty percent more than Indiana and Mississippi, the least generous states. Overall, New Jersey spends the most on UI during the sample period, $311.53 per covered worker, which is nearly four times as much as South Dakota's average, $78.98.

Figures 8, 9 and 10 and rows 6 through 14 of Table 2's panel A illustrate cross section variability in the 21 year raw data averages across states in AFDC, Medicaid and total state and local low income assistance spending. Table 2 shows the coefficient of variation for UIEXP and UIWEEKS is about equal to that for the comparable total state and local welfare variables SLEXP and SLPOP. The table also dramatically demonstrates the low variation in UIAWBA relative to the welfare measures. Further, unlike the UI program, no consistent pattern emerges between variation in total expenditure, recipients, and benefits per recipient in the three welfare programs.

B. The Importance of State Fixed Effects in UI and Welfare Policy Choices

This section examines whether the policy discretion visible in the raw data also exists once we have controlled for variation in economic and demographic characteristics. Our comparison across time and states between programs utilizes solely the estimated state fixed effects from equations (7) and (8), after controlling for variation in economic and demographic characteristics. Perhaps surprisingly, we find analysis of the estimated state fixed effects yields essentially the same results as the raw data averages.

The key assumption underlying the analysis of this section is that the state fixed effects capture explicit policy design elements by state governments. On the one hand, the assumption is very conservative. State demographic and economic characteristics not only measure the necessity for UI or welfare provision, but also capture political constituencies that are quite likely to alter state policy choices. On the other hand, the assumption is somewhat strong, as omitted state characteristics important for determining how a particular policy design is manifested by policy outcomes will be captured by the fixed effects variable. That is, policy outcomes are produced by how the, perhaps unmeasured, economic and demographic characteristics of the state population interact with the policy parameters as selected by the state government to 'produce' policy outcomes. Thus the fixed effect may not solely capture policy choices independent of the production of the program outcomes. We include as extensive as possible list for the demographic and economic vector of variables to minimize the possible impact of omitted variables.

Panel B of Table 2 reports two measures of cross section dispersion in the distributions of UI and low income assistance state fixed effects, the coefficient of variation and the interquartile ranges.[12] The reported fitted values are obtained by multiplying the estimated reduced form coefficients by national averages for all of the independent variables (including the estimated year fixed effects). Thus, variation across states is solely due to each state's estimated fixed effect.[13]

Variability in the estimated state fixed effects is presented in the scatterplots of Figures 11 and 12, as well as in the first five rows of panel B in Table 2. This data decisively rejects the hypothesis that all of the UI variation across states can be explained by demographic information, unemployment rates or industrial composition. These independent variables provide important, but incomplete, explanatory power in the regression. In fact, however, our analysis results in a greater degree of interstate dispersion in UI programmatic outcomes after controlling for observable characteristics. Using the state fixed effects, all five UI program outcomes are shown in Table 2 to exhibit greater

coefficients of variation than the raw data, and generally exhibit greater interquartile ranges as well. For example, the Figures show Nevada operates the least generous and Arkansas the most generous UI programs for the 48 states in the sample. Even if Arkansas and Nevada experience identical rates of unemployment, industrial composition and demographics, the former state is predicted to compensate more than six times as many workers than the latter in an average week. Further, as we observed in the raw UI data, interstate variation in total program expenditures is primarily accounted for by differences across states in the fraction of unemployment weeks compensated (UIWEEKS), not by differences in average weekly UI benefits (UIAWBA).

Despite the importance of the state fixed effects, the observable characteristics in the reduced form models explain a substantial fraction of variation in UI program outcomes. A comparison of Figures 11 and 12 to Figures 5 and 6 convey this fact. For example, Figure 11 indicates that while Arkansas operates the most generous UI program after controlling for the included variables, it appears rather average according to the raw data in Figure 6. Pennsylvania and Michigan also provide interesting contrasts. Figure 6 shows these two states operate apparently equivalent UI programs in terms of their raw data averages (their abbreviations actually overlap to the left of New Jersey). Upon controlling for the characteristics of their populations and economies as in Figure 11, Pennsylvania is revealed to grant substantially greater eligibility to its unemployed workers than does Michigan. Of course some states, such as Rhode Island and New Jersey, are shown to operate relatively generous UI programs whether or not we control for their observable characteristics.

The above analysis indicates that the two primary patterns observed in the raw data on UI outcomes cannot be explained by controlling for observable characteristics. First, variation in UI program outcomes appears incompletely tied to variation in state unemployment rates, demographic, or industrial compositions. Second, most of the variation in total UI expenditures arises because of differences across states in the criteria and administration of eligibility standards as revealed by recipients, not from criteria affecting

weekly unemployment benefits. The weight of diverse evidence presented in this section suggests a potentially diverse set of motives affecting states' design of UI programs.

Similarly, analysis of the welfare data shows the demographic and federal aid terms have important explanatory power, but that the state specific fixed effects terms nonetheless show considerable dispersion of welfare policy outcomes. Panel B of Table 2 shows the degree of variation in the fitted values for the welfare outcomes. Only for AFDC is interstate variation uniformly less than in the raw data. Figures 13-15 show the dispersion among states, and again that the relative ranking of many individual states changes considerably compared to the raw data.

D. Simultaneous Results Comparing UI and Low Income Assistance

Tables 3 and 4 present the parameter estimates for only the endogenous variables from the simultaneous model. Table 3 presents the coefficients on the UI variables in the welfare equations, while Table 4 presents the welfare variable parameters appearing on the RHS of the UI equations. In general, the results in the two tables are parallel. There are two central results in the tables. First, the interaction between the two different types of programs is statistically significant and quantitatively important. Second, AFDC is found to have a very different interaction with UI than Medicaid or total state and local welfare spending.

Panel A of Tables 3 and 4 show that increases in UIEXP significantly reduce real per capita AFDC expenditures, and vice versa. Note that UIEXP is measured in per worker terms, while AFEXP is in per capita terms. $1 in UI expenditures per worker is equivalent to about $.33 per capita. Thus $1 in per capita UI expenditures would result in about $.19 lower AFDC expenditures per capita (3 times -0.063). Similarly, the coefficient in Table 4 indicates that a $1 increase in per capita AFDC spending results in lower UI benefits paid per capita equal to approximately $.25 (.745 divided by 3).

The detail of Tables 3 and 4 show that the offset in UI or AFDC expenditure

in response to changes in the other program is because reductions in benefits per recipient outweigh the positive impact of recipients. That is, the negative coefficients on the benefit variables (-.261 in Table 3 and -.721 in Table 4) are much larger than the positive coefficients on the recipient variables (.030 in Table 3 and .382 in Table 4), so that total expenditures are reduced.

The results for Medicaid and total state local welfare expenditures are quite different. All of the significant coefficients are positive. That is, increases in UI benefits or recipients are associated with increases in Medicaid benefits and recipients. Increases in total state local benefits are positively associated with increases in UI benefits, although only UI recipients are found to increase state local recipients and not the other way around. And total state and local welfare expenditures positively influence UI expenditures, although surprisingly this is not true for Medicaid.

Tables 5 and 6 present simultaneous results using identical specifications, but for a reduced sample. In particular, it might be expected that states operating an Unemployed Parent component of the AFDC program (AFDC-UP) might be more generous than states without such a component, and so might be more likely to demonstrate a positive interaction between AFDC and UI. The model estimated for Tables 3 and 4 is therefore estimated for the 26 states with the AFDC-UP program. As illustrated in Tables 5 and 6, there is no qualitative change in the results affecting AFDC and UI.[14]

Thus the simultaneous model shows significant policy interaction between UI and welfare. Our reduced form model is not able to distinguish the causes of the interaction. One possibility explaining the interaction is an omitted variable, either pertaining to the economy or to potential recipients, is common to both welfare and UI policy outcomes. More likely, we believe, is that the associations reflect a common element in the expressed tastes by state governments over policy outcomes in UI and welfare. The difference in the results for AFDC compared to other welfare programs heightens this possibility. AFDC is virtually the only state controlled cash assistance program, and as such is more similar to UI than are the other welfare programs. A common omitted

variable would be expected to cause positive associations between all the programs. To the extent the simultaneous parameter estimates portray governmental tastes, however, the substitution indicated by the negative parameter estimates on AFDC and UI indicate that both programs contribute to the same goal as perceived by state government legislatures. In contrast under this interpretation, the positive association between commodity and all welfare programs illustrates common generosity across programs that attempt to solve different (commodity oriented) redistribution problems.

E. Estimation Results for Program Constituents

An alternative method for examining the simultaneous interaction between welfare and UI policy is presented in Tables 7, 8, and 9. Each table presents the parameter estimates from each pair of equations for the set of variables common to the UI and low income assistance regression models (the economic and demographic variables). Because the Medicaid and total state local equations are similar, we present only the total state and local welfare equations for the sake of brevity. Thus, estimates for each of the UI program outcomes are presented twice; once with the relevant AFDC policy as the endogenous right hand side variable, and once with the relevant total state and local low income assistance policy variable included in the model. We briefly examine a select subset of the exogenous variables in the regressions to assess the extent to which the institutionally segmented UI program appears to respond to variables that would be expected to affect low income assistance programs.

Coefficient estimates on many of the variables are difficult to interpret because of the reduced form nature of the equations. There are three variables, however, appearing to identify individual constituencies that would be expected to support low income assistance programs without being expected to support UI programs. In particular, the percentage of households under the poverty line (%POOR), the percentage of households headed by a female (FEMALEFAM), and the percentage of the population older than 64 years of age (ELDERLY) each identify a constituency group that would be expected to benefit from a particular low

income assistance program. That is, low income households would be expected to be most concerned with total welfare, female headed families would be expected to be most concerned with AFDC, and the elderly would be expected to be most concerned with Medicaid. While none of these categories are definitive, it nonetheless would be expected that these groups would preponderantly support programs with which they are most closely identified. None of the three groups have an obvious interest in the UI program.

Table 7 corroborates our intuition concerning all three of the low income assistance constituency variables, in that all three variables positively affect total welfare spending. For example, the elderly apparently have the greatest impact on total welfare spending, as a one percent greater population share results in a statistically significant $12.33 impact on per capita welfare spending, while female headed families and poverty families have about a significant $7.75 affect on total spending. Further, only female headed families positively impact AFDC expenditure, and the elderly actually are able to decrease AFDC.[16]

The three welfare constituency variables are informative in terms of assessing how the UI and various welfare programs interact. All three groups, the poor, the elderly, and female headed families, have statistically significant negative impacts on total welfare spending. Consistent with its dominant influence on welfare policy, Table 7 shows the elderly represent the strongest opponent to liberal UI spending. Thus, states with relatively large elderly populations appear to use savings from the operation of relatively strict UI programs to finance relatively generous expenditures on Medicaid and other types of low income assistance (excluding AFDC). The programmatic details provide further support for the constituency hypothesis (see note 16 for a discussion of the welfare programmatic details). Table 8 shows female headed families support a liberal definition of UI recipiency, as might be expected since they would have some, though perhaps a loose, attachment to the labor force (the coefficient on the poor, however, does not support this interpretation). As with total expenditures, the elderly represent the largest inhibition to both recipients and

benefits per recipient for UI.

In summary, the three variables that might be expected to most closely match the beneficiaries of each program are found to have generally positive impacts on the "own" program, and for the elderly to have negative impacts on the other programs. What is striking about these results is that the programmatic substitutions are as consistent for UI as for the individual welfare programs. Thus, at least according to the reduced form models and their necessarily cautious interpretations, there appear to be significant interactions among UI and different welfare policies.

IV. Summary and Conclusion

Our goal in this paper is to investigate whether there is a relationship between how state governments design UI and how they design low income assistance programs. For such a relationship to exist, we need to demonstrate that two barriers between UI and welfare programs are not operative. The first barrier is the lack of substantial interstate variation between UI programs which might occur if all states solve essentially identical insurance problems. The second is the institutional barrier presented by the trust fund arrangements that exclude UI from general fund financing in each state, so that states find it impossible to alter UI in response to other policies.

The evidence presented in our paper shows neither barrier to substitution between UI and low income assistance is operative. Our results powerfully suggest states do not design UI to solve identical, or even similar, insurance problems. We find tremendous interstate variation in UI, using raw UI data and using state specific residuals from a panel regression model controlling for an extensive array of economic and demographic factors. The state specific residuals demonstrate variation in the number of individuals on UI per covered worker of over six times between the most and least generous states.

Besides the degree of interstate variation, the type of interstate variation in UI is also important in suggesting motivation affecting state government design. Perhaps because of its insurance orientation, interstate

variation in UI occurs differently than interstate variation in welfare. While UI benefits per recipient show little interstate variation, welfare benefits are as variable as are recipient levels. Thus concerns over wage replacement rates, such as expressed in (Becker, 1980; Hamermesh, 1979), are not the first order cause of interstate variation in UI, as states have apparently come to a relative consensus over the level of benefits a deserving UI recipient should receive. There does not appear to be a consensus, however, on the definition of an appropriate recipient.[16] Interstate variation in UI recipients is as large as it is in welfare.

The most striking findings from our research arise in three results from our simultaneous exploration of the interaction between UI and welfare. These results clearly show the second barrier to UI and welfare programmatic substitution is not operative. First, despite the different patterns of interstate variation, our simultaneous analysis shows that UI and welfare programs are significantly related. Second, cash assistance from AFDC is found to substitute for cash assistance from UI in our simultaneous model, while taste complementarities overall between UI and total welfare apparently dominate, as states with large UI programs are found to also operate large welfare programs. Third, exogenous variables that can be identified with particular welfare program constituencies provide further evidence of programmatic interaction between UI and welfare. Large population shares of elderly, poor, and families headed by females are all associated with greater welfare expenditure and lower UI spending per worker.

We believe the comparison of UI to welfare is instructive, and offers a different approach for considering the context in which inter state programmatic variation occurs. UI does not appear to be solely an insurance program, but instead contains elements that affect program design in other areas, including welfare. To the extent the UI and welfare programs interact, our results suggest that UI can be seen as part of the broader "social safety net" of society. Our research has not yet fully described all the factors that impact program design for UI, but show such an exercise would be promising.[17] One perspective offered

by our work is that the interaction between UI and welfare suggests welfare reforms in the current policy debate may have rather extensive impacts on UI programs as well.

FOOTNOTES

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1. There has, however, been extensive research into the effects of this $14.3 billion (in 1989) program on the labor market decisions of workers and firms (Feldstein, 1978; Topel and Welch, 1980; Topel, 1983). The neglected issue, we believe, is how policy makers design their state's UI program. Holen and Horowitz (1974) attempt to incorporate UI policy design as an intermediate step to evaluating the effects of UI generosity on unemployment rates.

2. UI data, and most of the required welfare data, actually is available from 1965. We require, however, state-level industrial composition data which begins in 1969 for consistent SIC codes.

3. Our results are completely unaffected by using state population to normalize annual UI program benefits rather than the number of workers. Our definition of workers for this paper is workers covered by the UI program. As described below, we use population to normalize all welfare variables.

4. As an alternative interpretation of (4), note that average duration (UIAVGDUR) divided by 52 is the percentage of the year in which an unemployed worker is covered. This percentage times the percentage of workers who first receive UI payments equals the percentage of total weeks in which workers receive UI benefits.

5. Local welfare expenditures are included with state spending because for most jurisdictions local participation is mandated by state governments. Our measure of combined state and local welfare expenditure has netted out state-to-local aid.

6. In the case of Medicaid, the data is not available. The Food Stamp program was initiated on a non-experimental basis in 1969, but did not achieve complete coverage of all counties until January, 1975. Thus fiscal year 1976 is the first year for which Food Stamp recipients reflect welfare recipients nationwide.

7. For example, LN(UI) equals UIEXP lagged one year for the neighboring states in the UIEXP equation. Neighboring states are defined as those that share a common border.

8. To avoid collinearity, we omit one state fixed effect, Alabama, and one year fixed effect, 1969, from the panel regression model.

9. We discuss the implication of this assumption more fully below.

10. Because each of the five regressions contain identical independent variables, estimating the equations in (7) simultaneously as a seemingly unrelated set of equations is identical to OLS.

11. The fact that we only estimate the number of state and local welfare recipients using indirect data requires cautious interpretation of these trends.

12. For Medicaid and total state and local low-income assistance, we estimate models identical to our reduced form AFDC model, (7).

13. As an example, consider the fixed effect data for total UI expenditure per covered worker, UIEXP. Using the estimated regression coefficients and national averages for the independent variables, plus the estimated year fixed effects, the average state is predicted to spend $257.73 per covered worker during the sample period. Alabama is the state whose fixed effect is omitted from the regression, so Alabama is assigned a fitted value of $257.73. Texas, on the other hand, is estimated to have a state fixed effect equal to -185.86, so it is assigned a fitted value for UIEXPF equal to $71.87. By construction, the average of the fitted values across the 48 states equals the full-sample averages of the raw data ($182.90 for UIEXP, for example).

14. The only significant difference in the two sets of tables is for Medicaid, where the anomalous results of Table 3 and 4 no longer show, and instead some substitution is apparent between Medicaid and UI total expenditures through recipients. It is not clear why the Medicaid results would change using only AFDC-UP states. We incorporate the results of the full sample regression coefficients below.

15. The individual programmatic components generally also support our interpretation, with the exception of the positive impact of the elderly on AFDC recipients. But the elderly have a significantly negative impact on AFDC benefits per recipient, and are apparently able to funnel those funds into positive benefits per recipient in total welfare. The poor in general would not be expected to be as antithetical to AFDC, but also strongly support benefits per recipient in total welfare. Female headed families disproportionately use AFDC and not other welfare, but have only statistically insignificant effects on benefits per recipient.

16. For example Ragan (1984) discusses variation in rules determining initial UI eligibility through the definition of voluntary quits. Holen and Horowitz (1974) and Burgess (1992) discuss how variation in enforcement of job search requirements can determine the length of worker eligibility.

17. We leave for future research a careful comparison between the inter-industry cross subsidies of Adams and Anderson and Meyer to the individually motivated inter-personal subsidies suggested by our approach.

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Table 1: Definitions and Summary Statistics for UI and Welfare Variables

	Variable Name	Description of Variable	Mean	Standard Deviation
1.	UIEXP	UI expenditures per covered worker[abc]	182.90	100.48
2.	AFEXP	AFDC expenditures per capita	57.67	32.37
3.	MCEXP	Medicaid expenditures per capita	142.64	65.06
4.	SLEXP	Other State/Local Welfare expenditures per capita	254.44	98.06
5.	UIWEEKS	Percent of covered workers compensated for unemployment during an average week	2.66	1.31
6.	UIFIPAY	Percent of covered workers compensated for unemployment at any time during the year	10.34	4.31
7.	AFPOP	Percent of residents receiving AFDC benefits during an average month	3.97	1.47
8.	MCPOP	Percent of residents receiving Medicaid benefits during average month	7.87	2.79
9.	SLPOP	Percent of residents receiving State/Local welfare during average month[d]	10.56	4.04
10.	UIAWBA	UI average weekly benefit amount	139.08	18.61
11.	UIBEN	UI annual benefits received per initial recipient	1729.85	459.53
12.	AFBEN	AFDC annual benefits per recipient	1435.65	474.74
13.	MCBEN	Medicaid annual benefits per recip.	1876.35	641.80
14.	SLBEN	State/Local welfare benefits per recipient	2800.14	1268.51

[a] The summary statistics in this table are based on 48-state averages and standard deviations, where each state contributes its average value during the available sample time period. UI and AFDC variables are based on 1969 through 1989. Medicaid and state and local welfare expenditures per capita are based on 1969 through 1989, but recipients and benefits per recipient are based only on available data, 1976 through 1989. Arizona is excluded from the MCBEN and MCPOP samples.

[b] All dollar variables are measured in 1989, Alabama dollars.

[c] UI total expenditures per capita average 60.52 (st. dev. = 33.57).

[d] State and local welfare recipients are the non-overlap Food Stamps and AFDC populations.

Table 2: Cross-Section Distributions of UI and Welfare Program Variables

A. Raw Data Means

Variable	Coefficient of Variation[a]	Interquartile Range[b]
1. UIEXP	33.63	69.83 - 122.96
2. UIWEEKS	30.76	77.07 - 119.92
3. UIFIPAY	26.58	82.11 - 119.44
4. UIAWBA	10.28	91.63 - 105.52
5. UIBEN	20.26	83.57 - 112.90
6. AFEXP	51.58	59.25 - 129.39
7. AFPOP	33.10	72.54 - 123.17
8. AFBEN	30.83	75.75 - 120.73
9. MCEXP	44.54	76.39 - 113.80
10. MCPOP	33.57	69.76 - 123.13
11. MCBEN	26.13	84.87 - 111.16
12. SLEXP	34.44	77.34 - 116.56
13. SLPOP	35.20	74.05 - 124.91
14. SLBEN	38.54	65.36 - 118.11

B. State Fixed Effects from Reduced Form Panel Regressions[c]

Variable	Coefficient of Variation[a]	Interquartile Range[b]
1. UIEXPF	49.14	84.89 - 130.21
2. UIWEEKSF	35.17	76.69 - 127.82
3. UIFIPAYF	34.08	75.34 - 122.05
4. UIAWBAF	14.47	89.73 - 108.32
5. UIBENF	25.43	87.14 - 117.69
6. AFEXPF	32.69	80.58 - 116.02
7. AFPOPF	23.55	82.37 - 113.10
8. AFBENF	25.26	82.10 - 115.96
9. MCEXPF	56.39	67.14 - 127.04
10. MCPOPF	21.01	85.26 - 114.61
11. MCBENF	54.64	62.99 - 122.10
12. SLEXPF	41.60	73.10 - 110.18
13. SLPOPF	21.27	83.90 - 108.14
14. SLBENF	47.40	61.86 - 126.44

[a] Coefficient of variation is defined as the standard deviation divided by the mean.

[b] Values reported for the interquartile range have been divided by sample means. Thus these are fractions of the average, which are comparable across variables.

[c] F at the end of the variable name denotes fitted values based on differences in estimated state specific fixed effects (see text).

TABLE 3. 3SLS ESTIMATES OF THE SIMULTANEOUS WELFARE AND UNEMPLOYMENT INSURANCE MODEL: UI PROGRAM ENDOGENOUS

A. AFDC PROGRAM

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
AFEXP	-0.063* (0.019)	--	--
AFPOP	--	0.030 (0.021)	--
AFBEN	--	--	-0.261* (0.050)

B. MEDICAID PROGRAM

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
MCEXP	0.058 (0.045)	--	--
MCPOP[1]	--	2.59* (0.48)	--
MCBEN[1]	--	--	0.481* (0.097)

C. TOTAL WELFARE

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
SLEXP	0.280* (0.057)	--	--
SLPOP[1]	--	0.133* (0.043)	--
SLBEN[1]	--	--	0.880* (0.174)

[1] The MCPOP and MCBEN regressions, and therefore the SLPOP and SLBEN regressions, are based on 1976-89 data (see text). All others are based on 1969-89 data.

TABLE 4. 3SLS ESTIMATES OF THE SIMULTANEOUS WELFARE AND UI MODEL: WELFARE PROGRAM ENDOGENOUS

A. AFDC PROGRAM

Dependent Variable	Endogenous Explanatory Variables AFEXP	AFPOP	AFBEN
UIEXP	-0.746* (0.351)	--	--
UIFIPAY	--	0.382* (0.216)	--
UIBEN	--	--	-0.721* (0.155)

B. MEDICAID PROGRAM

Dependent Variable	Endogenous Explanatory Variables MCEXP	MCPOP	MCBEN
UIEXP[1]	-0.213 (0.222)	--	--
UIFIPAY[1]	--	0.046* (0.014)	--
UIBEN[1]	--	--	0.289* (0.090)

C. TOTAL WELFARE

Dependent Variable	Endogenous Explanatory Variables SLEXP	SLPOP	SLBEN
UIEXP	0.334* (0.114)	--	--
UIFIPAY[1]	--	-0.012 (0.135)	--
UIBEN[1]	--	--	0.269* (0.048)

[1] UI regressions using MCPOP and MCBEN, and therefore using SLPOP and SLBEN, are based on 1976-89 data (see text). All others are based on 1969-89 data.

TABLE 5. 3SLS ESTIMATES OF THE SIMULTANEOUS WELFARE AND UI MODEL: UI PROGRAM ENDOGENOUS FOR STATES WITH AFDC-UP PROGRAMS

A. AFDC PROGRAM

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
AFEXP	-0.066* (0.027)	--	--
AFPOP	--	0.122* (0.025)	--
AFBEN	--	--	-0.302* (0.054)

B. MEDICAID PROGRAM

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
MCEXP[1]	-0.136* (0.047)	--	--
MCPOP[1]	--	-0.083 (0.053)	--
MCBEN[1]	--	--	0.193* (0.068)

C. TOTAL WELFARE

Dependent Variable	Endogenous Explanatory Variables UIEXP	UIFIPAY	UIBEN
SLEXP	0.198* (0.079)	--	--
SLPOP[1]	--	0.218* (0.044)	--
SLBEN[1]	--	--	0.491* (0.138)

[1] Medicaid expenditure, recipients and benefits per recipient, and total welfare recipients and benefits per recipient, are based on 1976-89 data (see text). All others are based on 1969-89 data.

TABLE 6. 3SLS ESTIMATES OF THE SIMULTANEOUS WELFARE AND UI MODEL: WELFARE PROGRAM ENDOGENOUS FOR STATES WITH AFDC-UP PROGRAMS

A. AFDC PROGRAM

Dependent Variable	Endogenous Explanatory Variables AFEXP	AFPOP	AFBEN
UIEXP	-0.519 (0.413)	--	--
UIFIPAY	--	1.624* (0.293)	--
UIBEN	--	--	-1.266* (0.225)

B. MEDICAID PROGRAM

Dependent Variable	Endogenous Explanatory Variables MCEXP	MCPOP	MCBEN
UIEXP[1]	-1.396* (0.294)	--	--
UIFIPAY[1]	--	-0.354* (0.231)	--
UIBEN[1]	--	--	0.428* (0.184)

C. TOTAL WELFARE

Dependent Variable	Endogenous Explanatory Variables SLEXP	SLPOP	SLBEN
UIEXP	0.088 (0.149)	--	--
UIFIPAY[1]	--	0.450* (0.172)	--
UIBEN[1]	--	--	0.330* (0.078)

[1] UI regressions using Medicaid expenditure, recipients and benefits per recipient, and total welfare recipients and benefits per recipient, are based on 1976-89 data (see text). All others are based on 1969-89 data.

TABLE 7. Expenditure Model: Exogenous Variable Coefficients[1]
3SLS Regressions Using Pooled Data: 1969-89

Independent Variables	SYSTEM I UIEXP	SYSTEM I SLEXP	SYSTEM II UIEXP[2]	SYSTEM II AFDCEXP
UNEMP	29.35*	-9.19*	29.30*	1.69*
	(1.65)	(2.01)	(1.60)	(0.68)
INCOME	-0.003	0.006*	-0.003	-0.65
	(0.004)	(0.002)	(0.003)	(0.64)
CPI	62.25	-67.66	46.61	29.31
	(126.89)	(78.17)	(131.25)	(26.07)
POP	0.004	-0.007*	0.002	0.004*
	(0.003)	(0.002)	(0.003)	(0.001)
$NeigEXP^{3}_{t-1}$	0.07*	0.27*	0.06	0.25*
	(0.04)	(0.05)	(0.04)	(0.05)
%COLLEGE	-3.31	2.83*	-2.72	-0.98*
	(2.11)	(1.37)	(2.18)	(0.46)
%HIGHSCH	-1.75	2.64*	-0.30	0.90*
	(1.53)	(0.94)	(1.58)	(0.31)
%FEMALEFAM	-16.78*	7.61*	-6.70	4.74*
	(6.28)	(4.32)	(6.81)	(1.46)
%METRO	-0.36	0.07	-0.49	-0.09
	(0.34)	(0.25)	(0.35)	(0.08)
%ELDERLY	-24.55*	12.33*	-22.93*	-1.46*
	(3.62)	(2.61)	(3.65)	(0.88)
%POOR	-6.67*	7.81*	-2.29	0.25
	(2.39)	(1.56)	(2.41)	(0.52)
%WHITE	1.43	2.20*	3.88*	1.42*
	(1.35)	(0.86)	(1.40)	(0.29)
R-sq	0.84	0.92	0.83	0.92

[1] Variables common to both the unemployment and welfare regressions, see text. There are 1008 observations.

[2] We present the UIEXP coefficients twice because the endogenous right hand side variable is different.

[3] Average of neighboring states' left-hand side variable, lagged one year (see text).

TABLE 8. Recipient Model: Exogenous Variable Coefficients[1]
3SLS Regressions Using Pooled Data

Independent Variables	SYSTEM III UIFIPAY	SYSTEM III SLPOP	SYSTEM IV UIFIPAY[2]	SYSTEM IV AFDCPOP
UNEMP	0.61* (0.08)	0.004 (0.04)	0.90* (0.07)	0.01 (0.03)
INCOME	0.08 (0.19)	-0.21* (0.07)	-0.26* (0.14)	-0.06* (0.03)
CPI	6.70 (5.72)	2.85 (2.50)	2.09 (5.31)	1.16 (1.31)
POP	0.36* (0.15)	0.19* (0.07)	0.18 (0.11)	0.10* (0.03)
$NeigPOP^{3}_{t-1}$	0.24* (0.05)	-0.0002 (0.003)	0.19* (0.04)	0.039* (0.004)
%COLLEGE	0.18* (0.10)	0.05 (0.05)	-0.18* (0.09)	0.03 (0.02)
%HIGHSCH	0.01 (0.06)	0.04 (0.03)	-0.02 (0.06)	0.02 (0.02)
%FEMALEFAM	1.62* (0.37)	-0.54* (0.21)	0.17 (0.27)	0.12* (0.07)
%METRO	0.01 (0.01)	-0.005 (0.006)	0.001 (0.01)	-0.004 (0.004)
%ELDERLY	-0.95* (0.24)	0.34* (0.13)	-0.50* (0.15)	0.08* (0.04)
%POOR	-0.45* (0.13)	-0.03 (0.06)	-0.44* (0.10)	0.11* (0.03)
%WHITE	0.07 (0.06)	-0.01 (0.03)	-0.09* (0.05)	0.04* (0.01)
R-sq	0.87	0.97	0.85	0.90

[1] Variables common to both the unemployment and welfare regressions, see text. There are 672 observations in System III (1976-89), and 1008 in System IV (1969-89).

[2] We present the UIFIPAY coefficients twice because the endogenous right hand side variable is different.

[3] Average of neighboring states' left-hand side variable, lagged one year (see text).

TABLE 9. Benefits Model: Exogenous Variable Coefficients[1]
3SLS Regressions Using Pooled Data

Independent Variables	SYSTEM V UIBEN	SYSTEM V SLBEN	SYSTEM VI UIBEN[2]	SYSTEM VI AFDCBEN
UNEMP	63.35*	-49.35*	73.07*	1.67
	(10.44)	(22.71)	(8.57)	(6.82)
INCOME	-54.66	391.00*	76.29*	57.21*
	(37.43)	(41.40)	(18.99)	(9.86)
CPI	-1328.23	2484.14*	499.67	892.28*
	(881.35)	(1454.95)	(679.43)	(373.88)
POP	77.24*	-183.63*	31.86	57.03*
	(23.28)	(46.65)	(16.85)	(9.21)
$NeigBEN^{3}_{t-1}$	0.03	178.20*	0.03	0.10*
	(0.07)	(36.85)	(0.05)	(0.06)
%COLLEGE	-14.58	11.18	-52.75*	-36.11*
	(15.23)	(27.86)	(11.92)	(6.73)
%HIGHSCH	-8.17	30.25*	9.97	18.30*
	(9.53)	(17.15)	(8.70)	(4.46)
%FEMALEFAM	-129.10*	-91.03	-78.42*	1.35
	(60.25)	(121.46)	(34.25)	(21.12)
%METRO	-0.09	-1.00	-2.77	-2.54*
	(1.80)	(3.70)	(1.87)	(1.21)
%ELDERLY	-162.17*	150.29*	-132.73*	-55.06*
	(36.13)	(73.35)	(19.69)	(12.11)
%POOR	25.34	147.09*	48.25*	11.15
	(20.59)	(37.92)	(12.07)	(7.47)
%WHITE	2.97	13.75	17.45*	14.15*
	(8.83)	(16.50)	(7.37)	(4.12)
R-sq	0.81	0.90	0.77	0.92

[1] Variables common to both the unemployment and welfare regressions, see text. There are 672 observations in System V (1976-89), and 1008 in System VI (1969-89).

[2] We present the UIBEN coefficients twice because the endogenous right hand side variable is different.

[3] Average of neighboring states' left-hand side variable, lagged one year (see text).

Figure 1. Time-Series Plots of UI Variables:
Raw Data Averages across 48 States

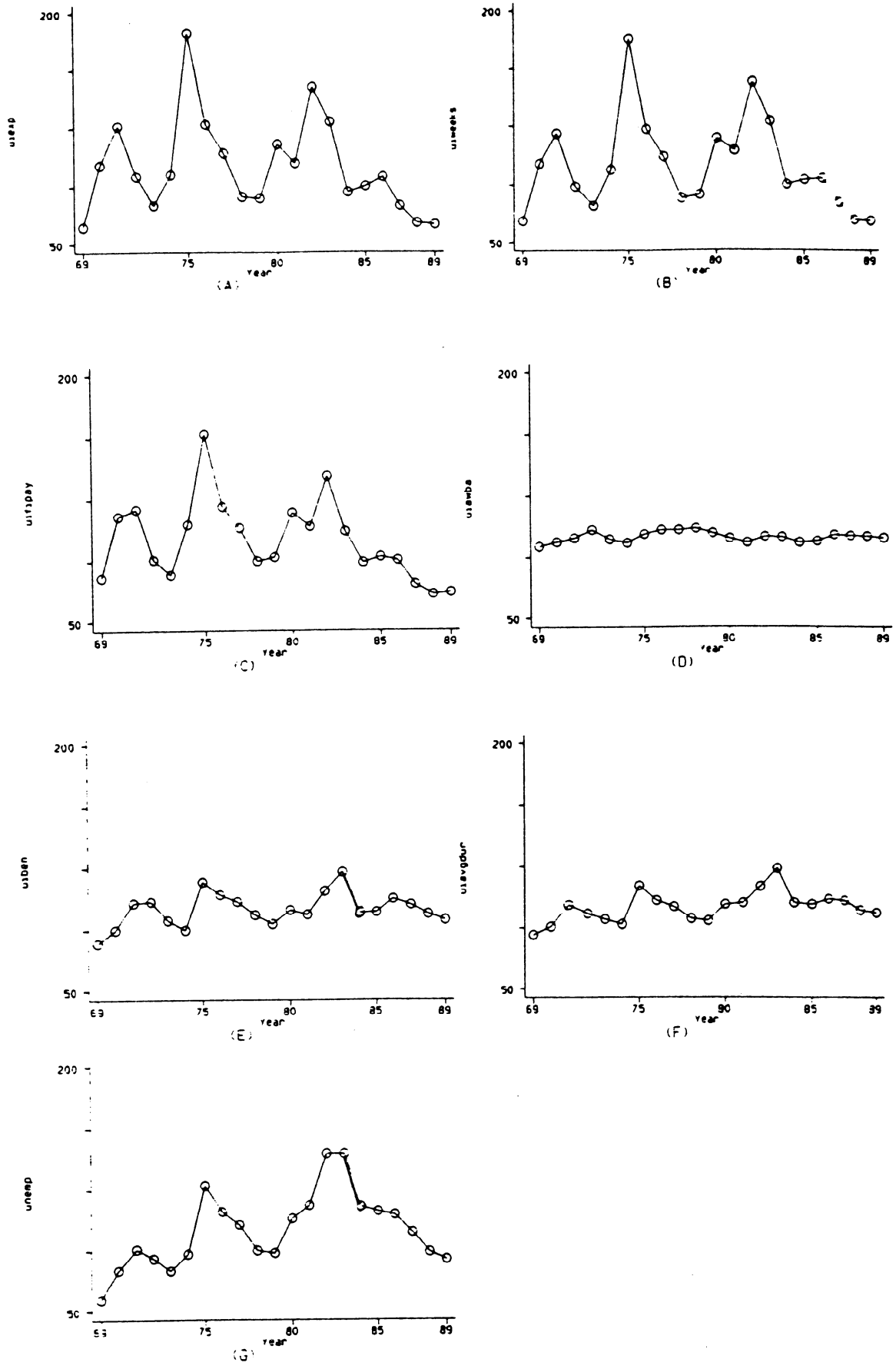


Figure 2. Time-Series Plots of AFDC Variables:
Raw Data Averages across 48 States

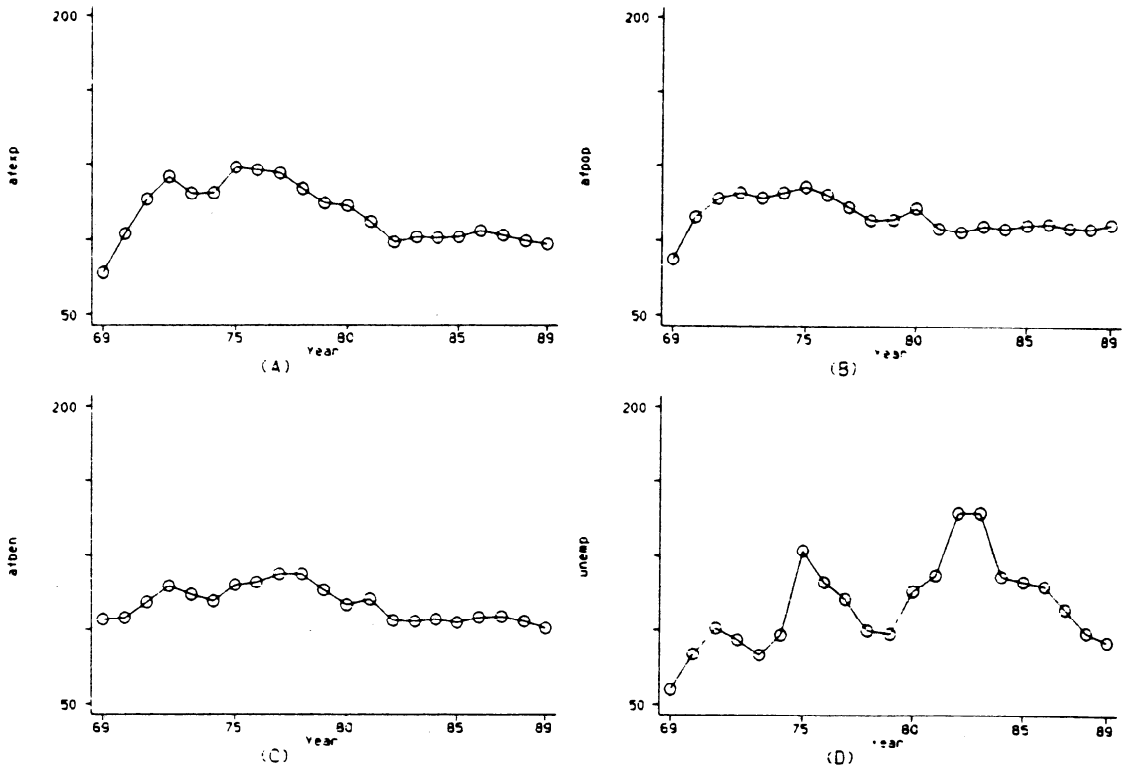


Figure 3. Time-Series Plots of Medicaid Variables:
Raw Data Averages across 48 States

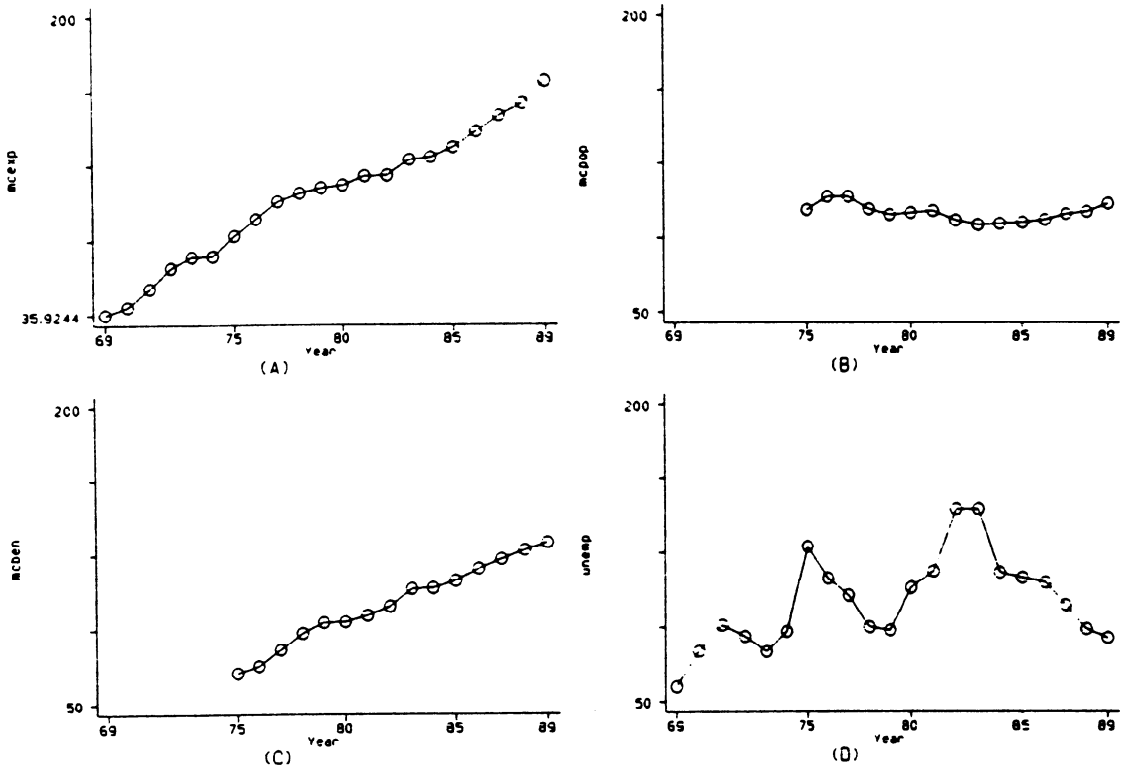


Figure 1. Time-Series Plots of State/Local Welfare Variables: Raw Data Averages across 48 States

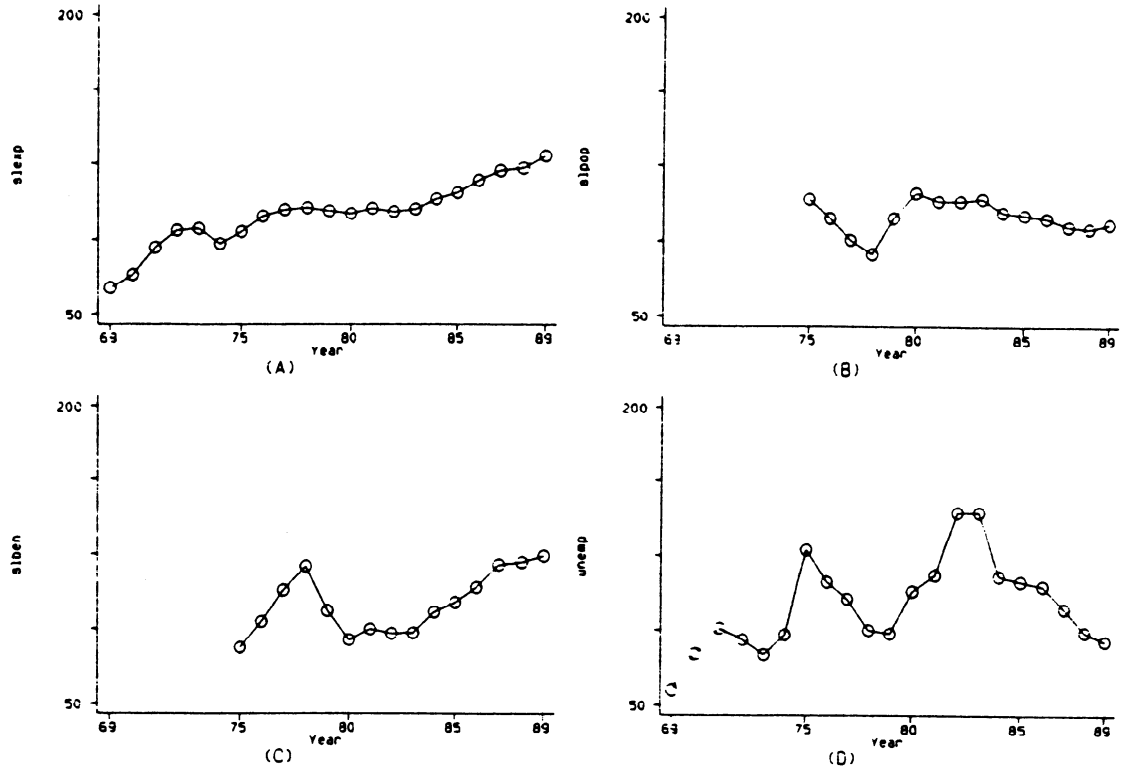


Figure 5. Cross-Section Distribution for UI Variables:
Raw Data Averages, 1969-1989

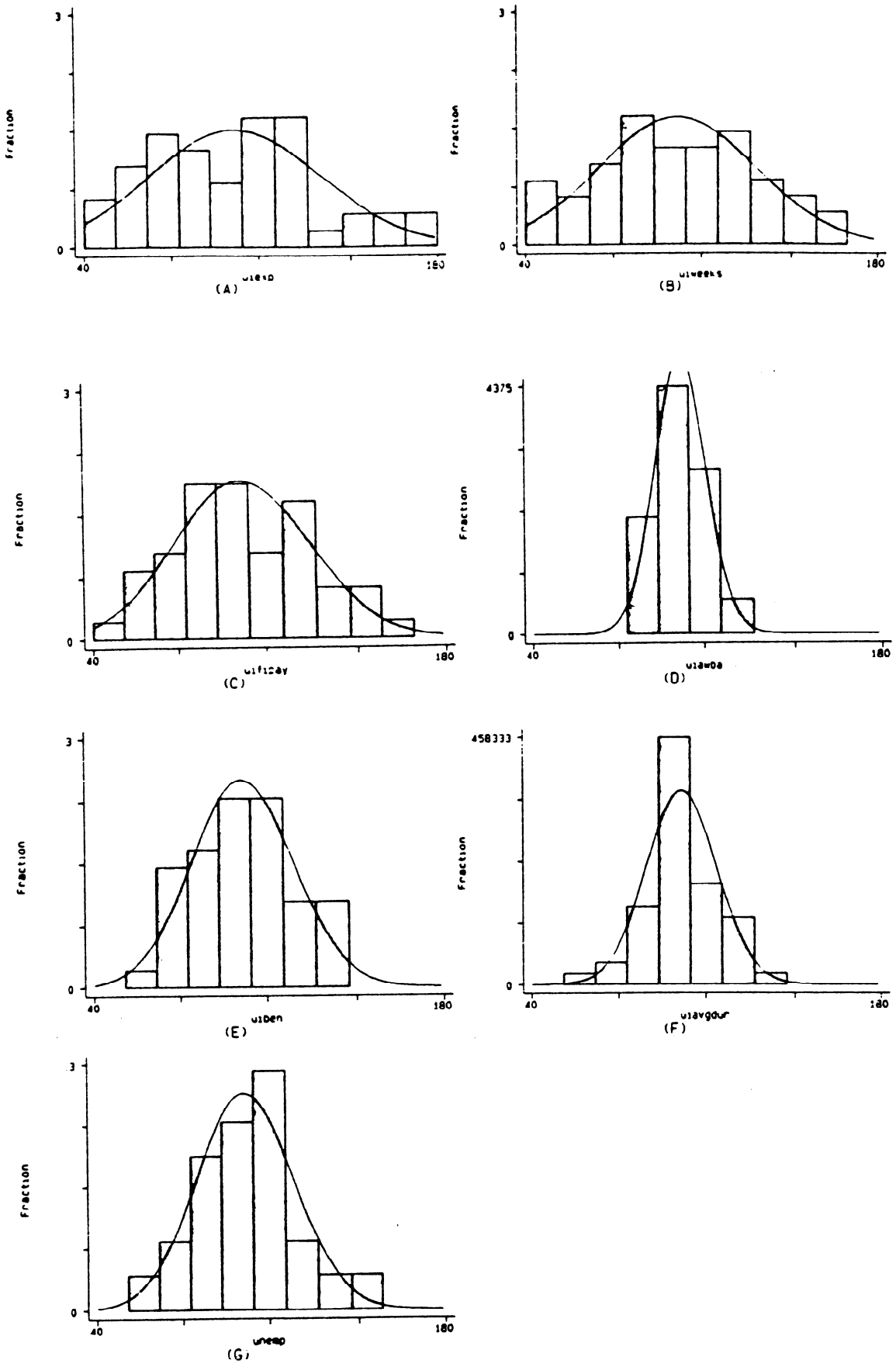


Figure 6. State UI Program Variables:
Raw Data Averages, 1969-1989

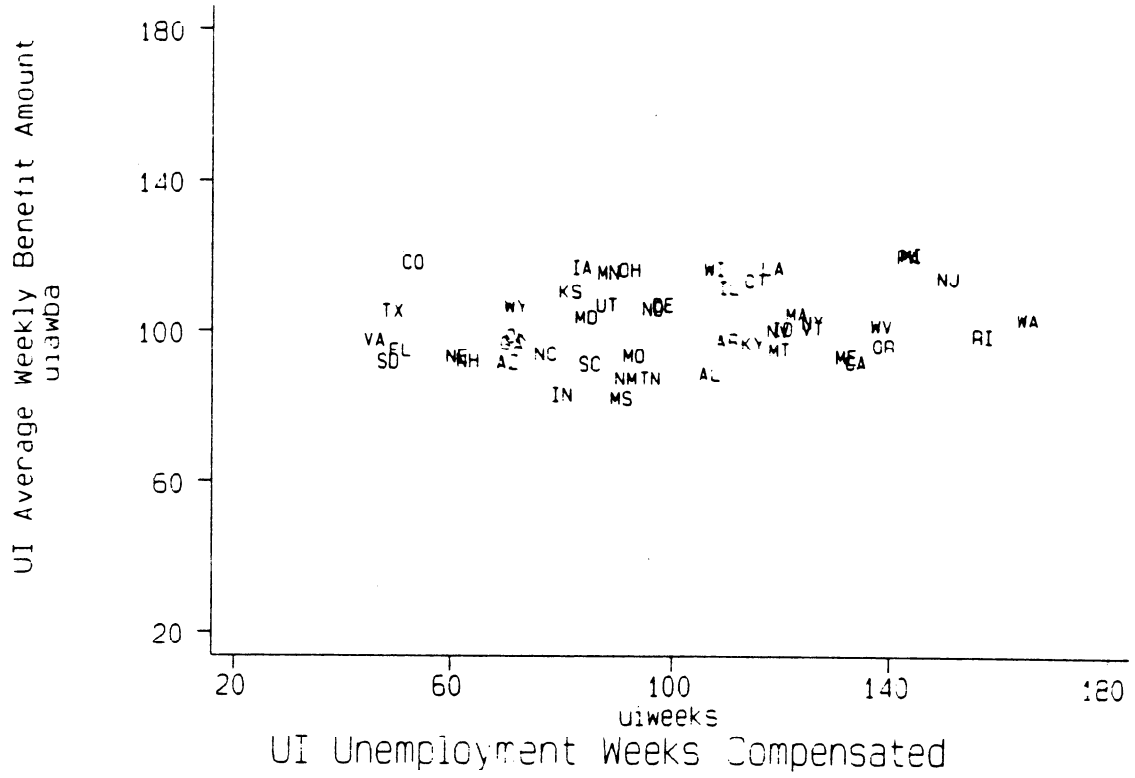


Figure 7. State UI Program Variables:
Raw Data Averages, 1969-1989

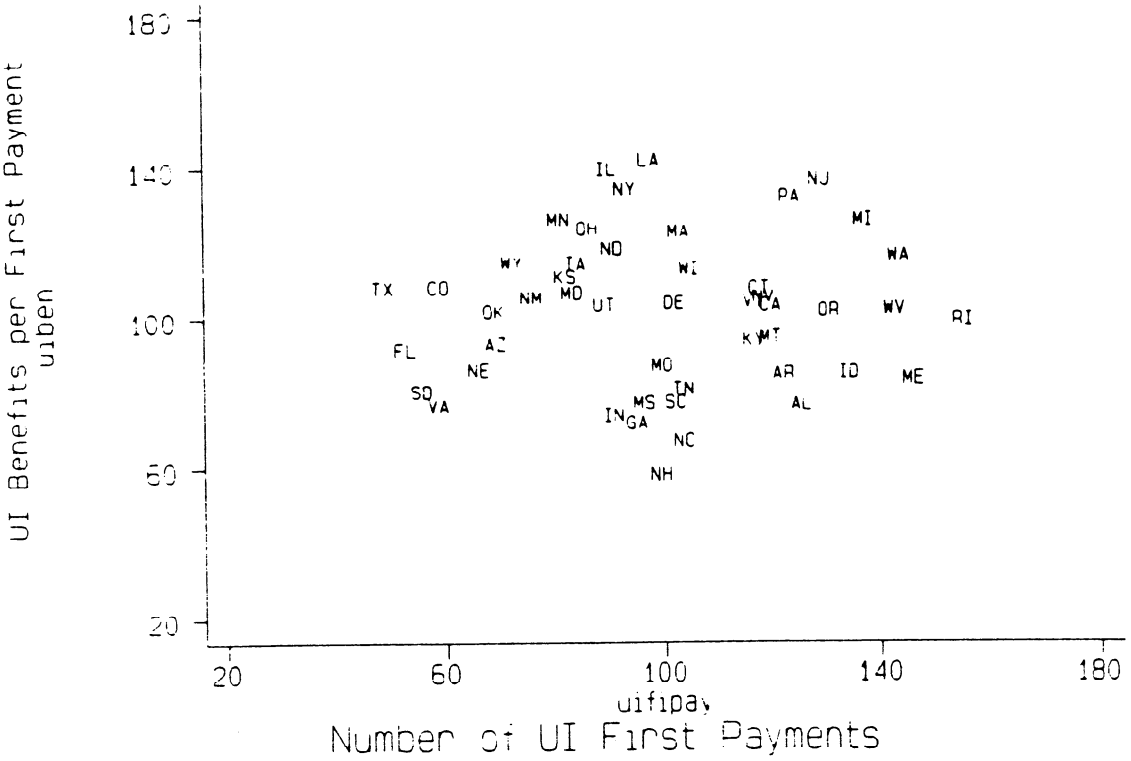


Figure 8. State AFDC Program Variables:
Raw Data Averages, 1969-1989

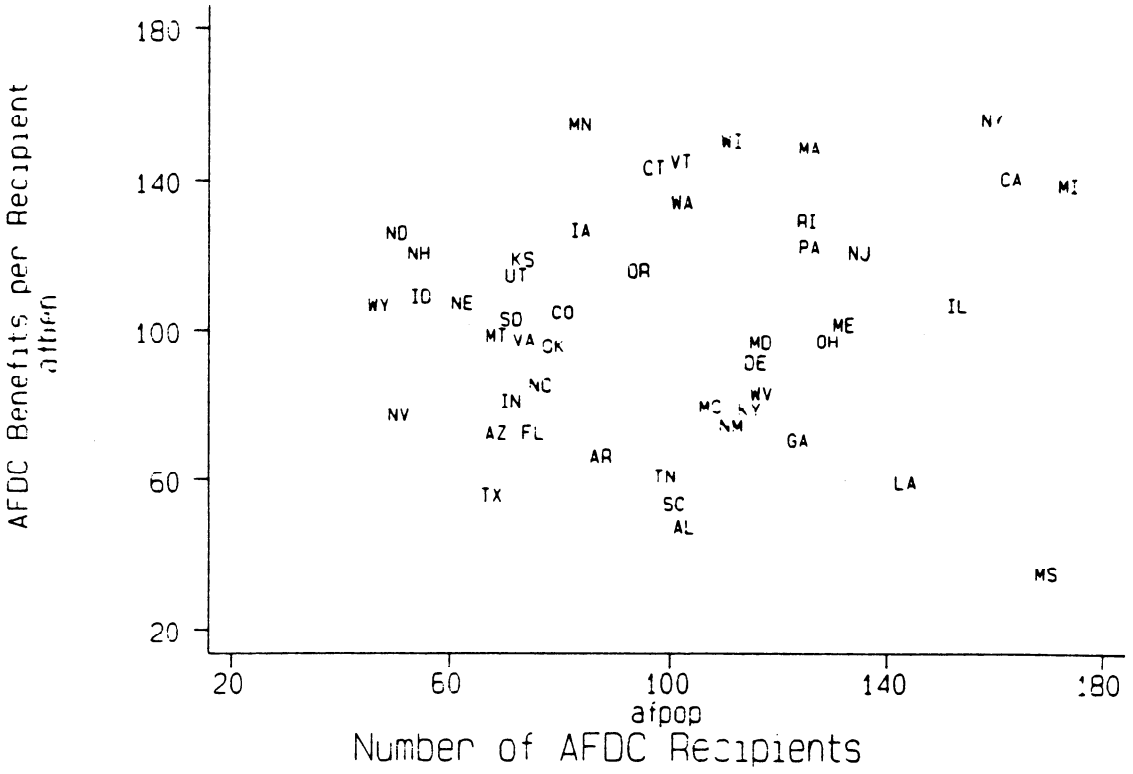


Figure 9. State Medicaid Program Variables:
Raw Data Averages, 1969-1989

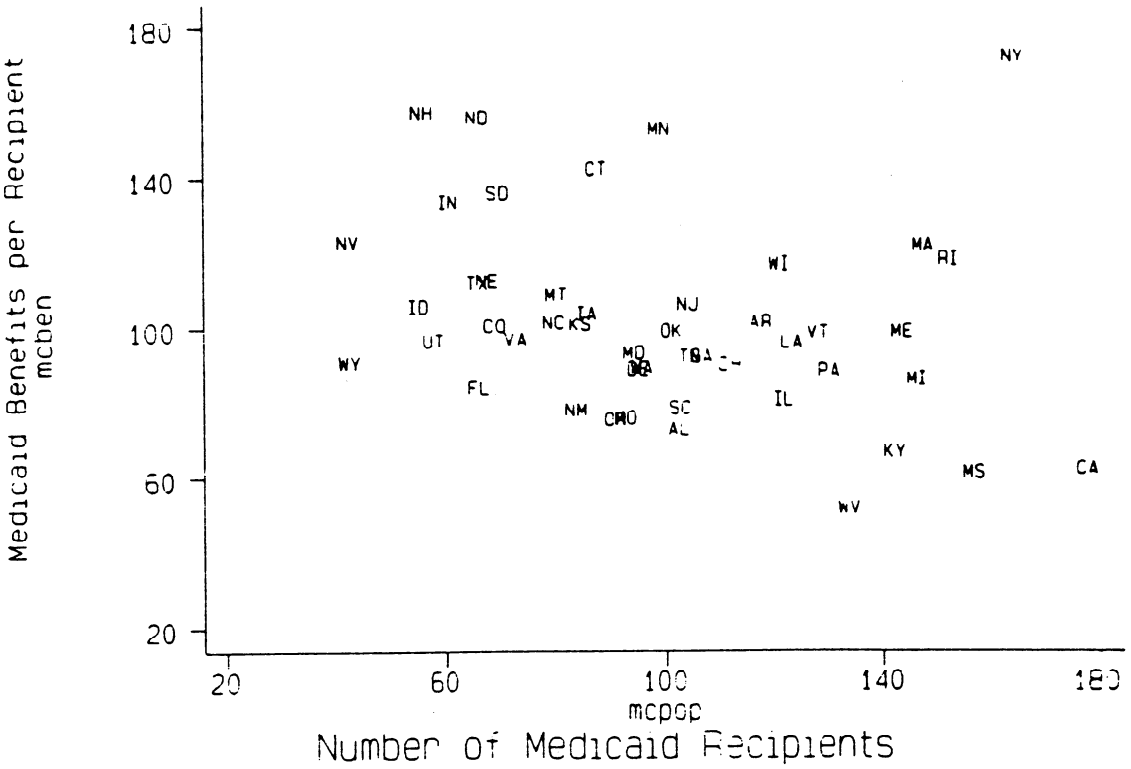


Figure 10. State/Local Welfare Variables: Raw Data Averages, 1976-1989

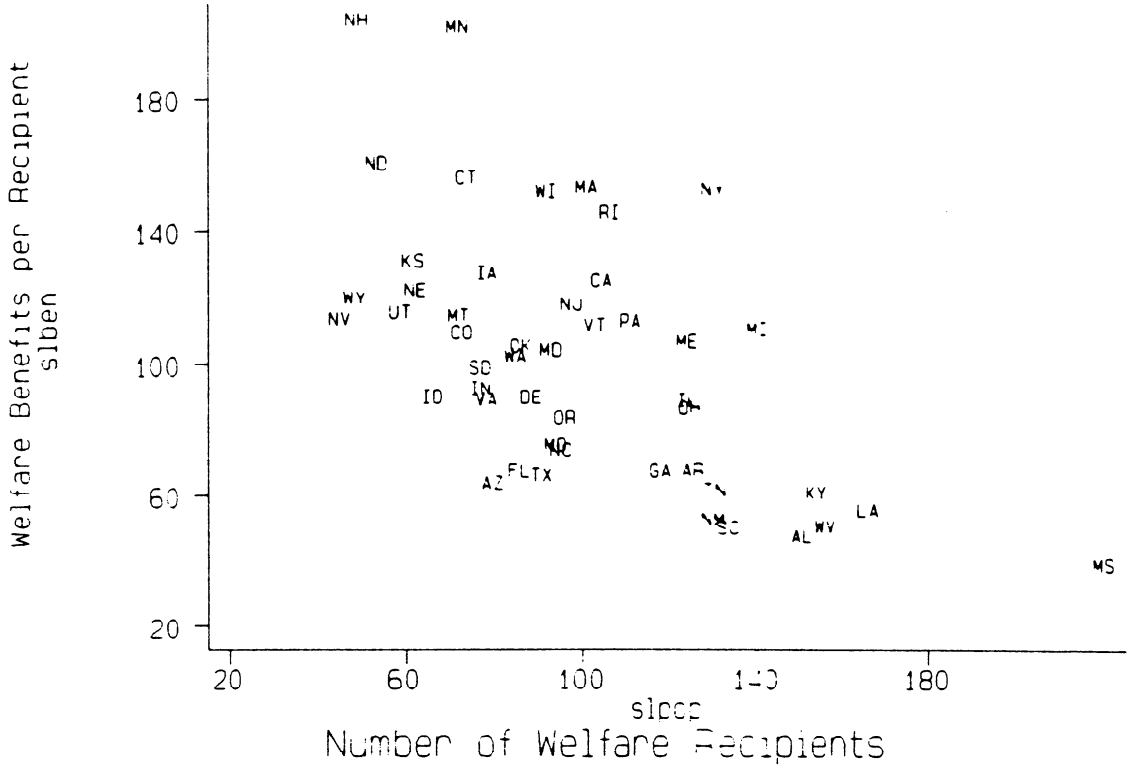


Figure 11. State UI Program Variables:
Fitted Data Averages, 1969-1989

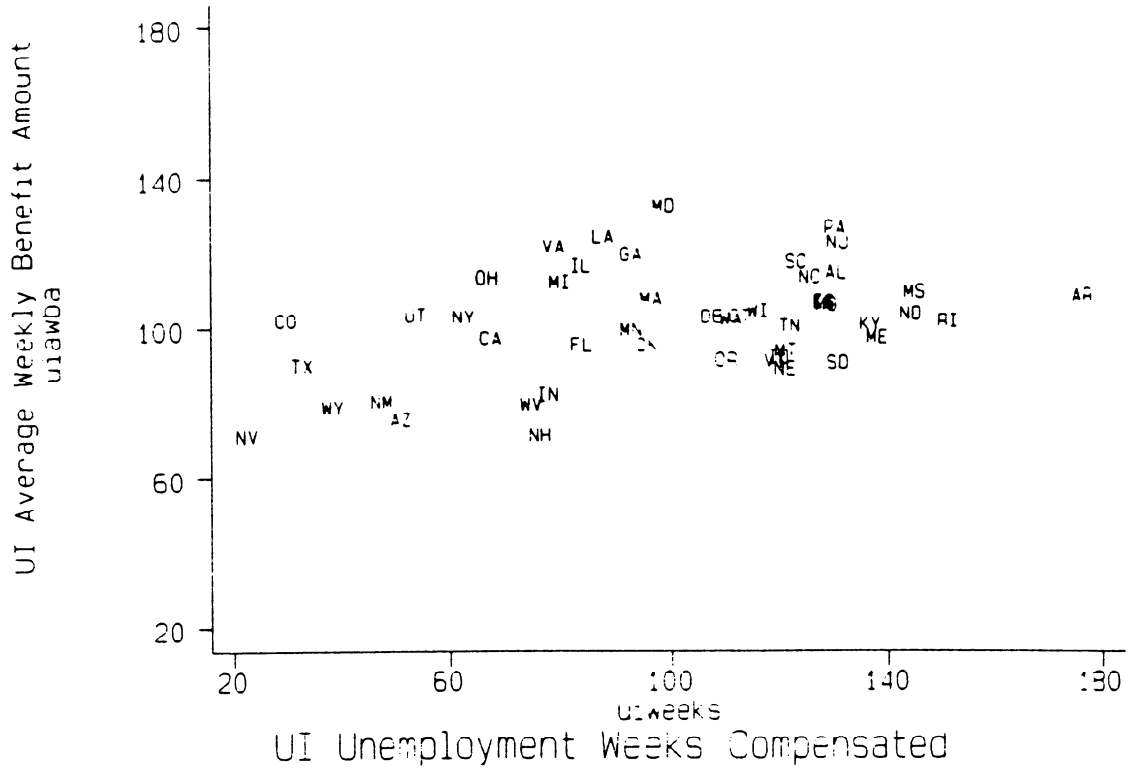


Figure 12. State UI Program Variables:
Fitted Data Averages, 1969-1989

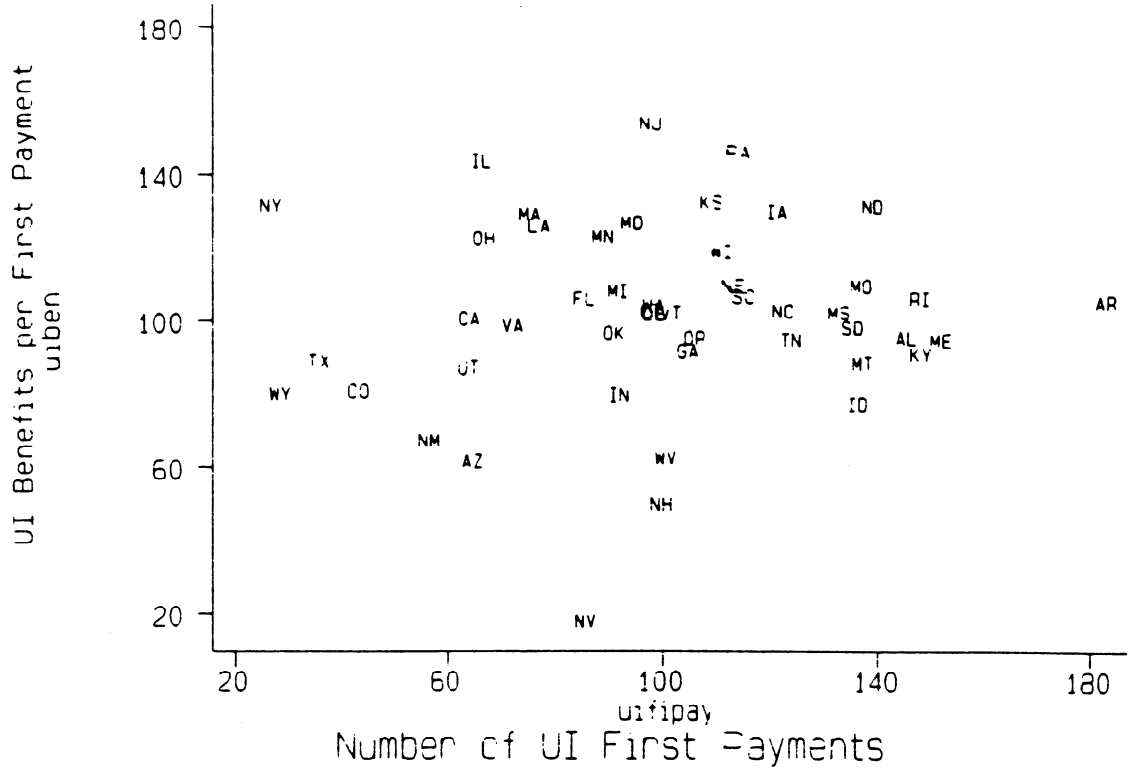


Figure 13. State AFDC Program Variables: Fitted Data Averages, 1969-1989

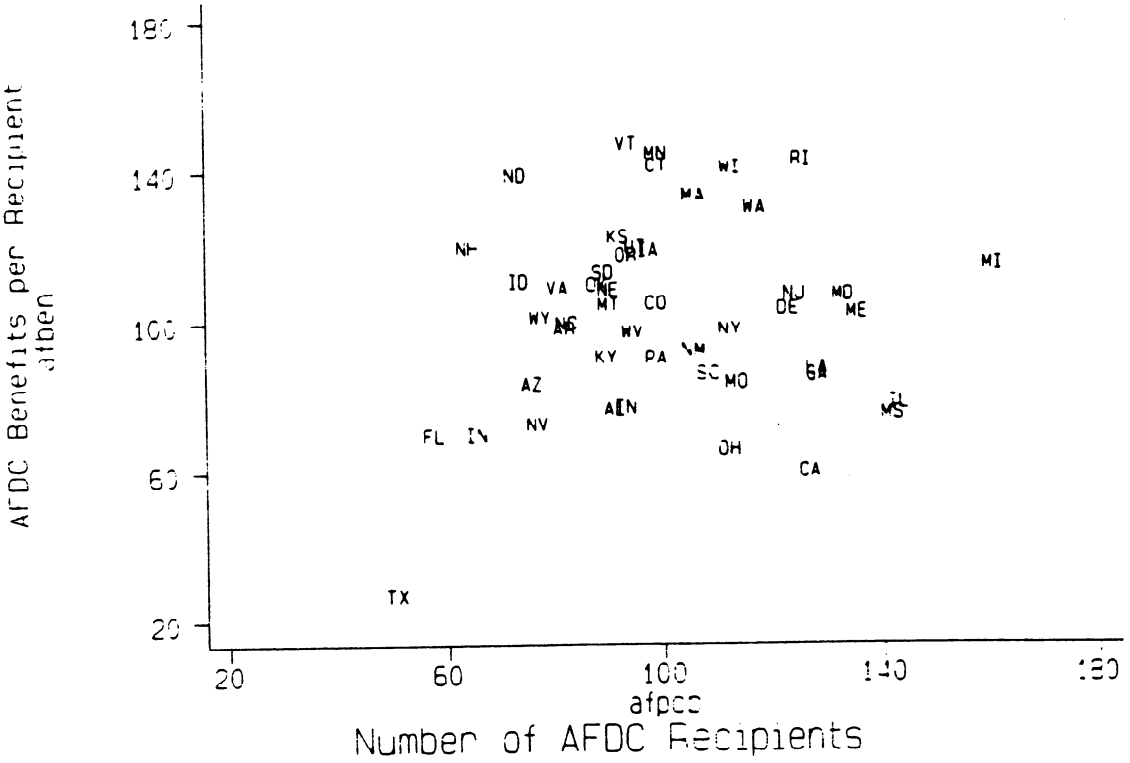


Figure 14. State Medicaid Program Variables.
Fitted Data Averages, 1969-1989

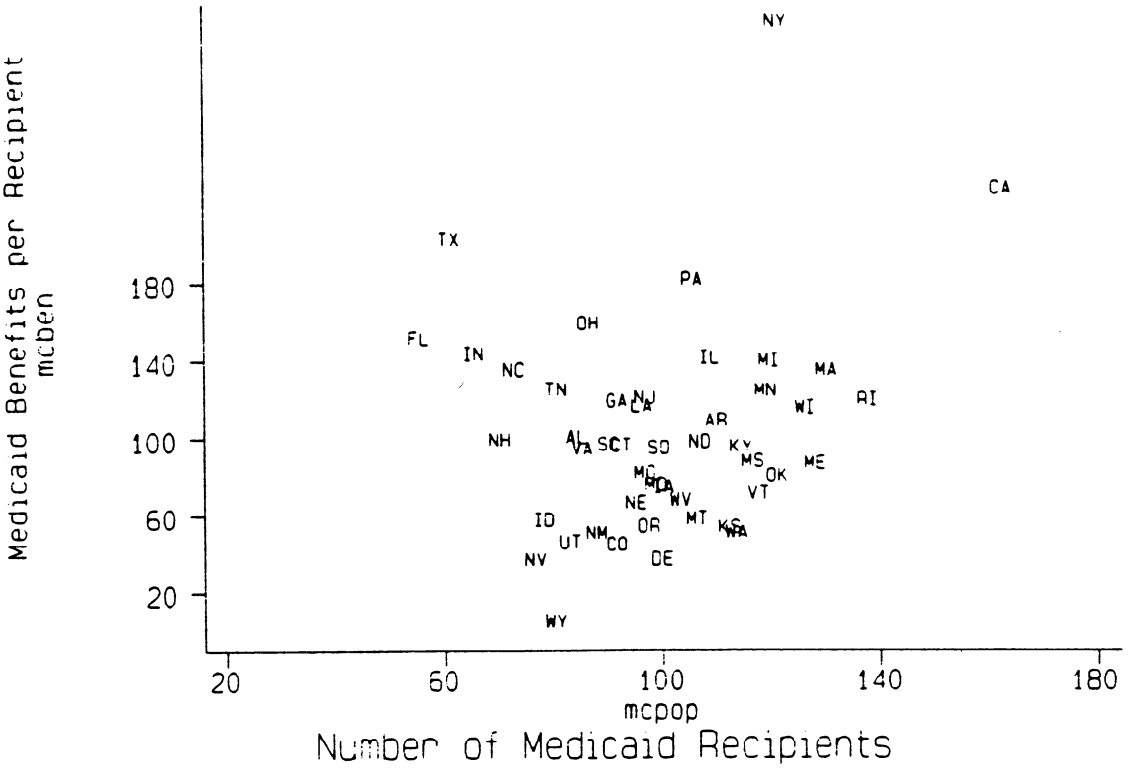
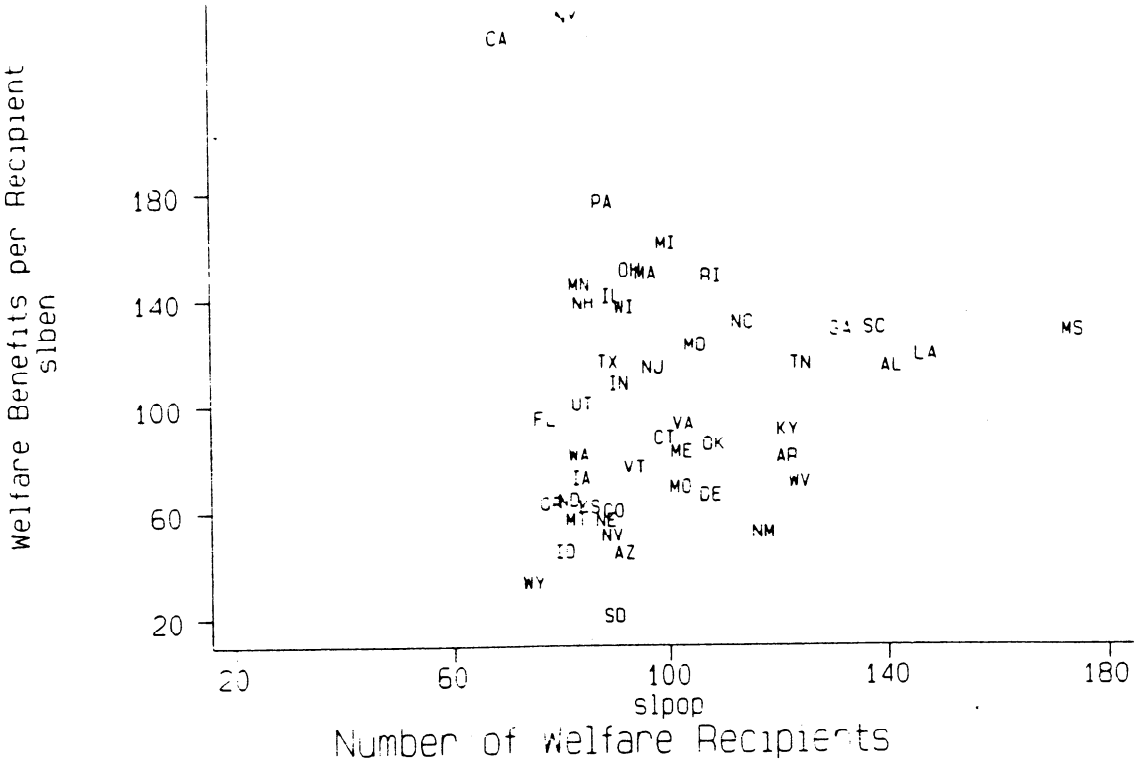


Figure 15. State/Local Welfare Variables: Fitted Data Averages, 1969-1989



Unemployment Insurance, Consumption Smoothing, and Private Insurance: Evidence from the PSID and CEX

Jonathan Gruber
MIT and NBER

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A major source of income support for unemployed workers in the U.S., as elsewhere in the world, is publicly-provided unemployment insurance (UI). At the height of the most recent U.S. recession (1991), 10.2 million workers received unemployment insurance, and the annual cost of the program to the Federal and state governments was $27 billion. Research over the past 20 years has provided a very good understanding of the efficiency consequences of this public income support for the operation of the labor market. A long line of work, culminating in Meyer (1989, 1990), has shown that more generous UI benefits leads to longer unemployment durations among UI recipients. And Feldstein (1978), Topel (1983), Card and Levine (1991), and Anderson and Meyer (1993) have found that more imperfect experience rating under UI has led to excess temporary layoffs by U.S. firms.

While there is conclusive evidence on the *costs* of unemployment insurance, however, there is little evidence on the *benefits* of the program. There are two traditional justifications for unemployment insurance. The first is that it helps to subsidize efficient search by liquidity constrained unemployed workers. But recent research has shown that the longer search induced by more generous unemployment insurance benefits does not result in better job matches, as measured by the ultimate wage received (Meyer, 1989; Woodbury and Speigelman, 1987). The second is that it mitigates the fall in consumption of individuals who, due either to myopia or some capital market failure, are unable to smooth their own consumption during unemployment spells. There is little evidence on this second channel for the benefits of unemployment insurance.[1]

The goal of this paper is to assess those benefits by estimating the effects of UI on

[1]A third traditional justification for UI is that it serves as an automatic stabilizer, reducing the severity of recessions by redistributing from good times to bad. There is little direct evidence on the automatic stabilization properties of UI. A finding that UI smooths consumption at the level of the individual may provide indirect evidence on its success as an automatic stabilizer.

consumption smoothing during periods of joblessness. This goes directly to the question of *benefit adequacy*. The adequacy of UI is appropriately measured by the extent to which UI allows the unemployed individual to maintain her previous level of consumption. Several past studies have attempted to assess adequacy by measuring the generosity of UI benefits relative to pre-displacement earnings or consumption (See O'Leary, 1994, and the references therein) If individuals are myopic, and if they have no access to other forms of income during their unemployment spell, then this is the appropriate methodology. If, however, unemployed individuals are forward looking and can save or borrow, or if they have access to other forms of consumption insurance, such as savings, borrowing, or the labor supply of other family members, then the replacement rate itself does not measure the effect of UI on consumption. This effect will, instead, be a function of how these other forms of consumption insurance interact with UI. For example, if UI just crowds out other forms of private consumption insurance, then it will have no effect on consumption, regardless of the replacement rate. Measuring benefit adequacy, therefore, requires either information on the net effect of UI generosity on consumption smoothing among the unemployed, or measures of the extent to which UI crowds out other forms of consumption insurance.

I attempt to provide both types of evidence in this paper. First, I directly estimate the relationship between consumption changes from unemployment and the level of UI generosity. I then model the relationship between UI and other forms of private insurance, and ask whether the results are consistent with my consumption smoothing findings. The empirical model used is identified by using differences in UI benefits *eligibility* across individuals. Differences in the benefits available to the unemployed arise from the substantial variation in the generosity of this state-administered program over states and time over the last 25 years. This variation has been exploited before to estimate the effect of UI on firm layoff behavior and worker search behavior, but has not been

applied to assess the benefits of UI. I build a detailed simulation program of the structure of the UI system in each state since 1968. I then apply this program to data on consumption from two sources. The first, the Panel Study of Income Dynamics (PSID), is a longitudinal data set which contains excellent information on employment histories as well as annual observations on food and housing expenditures for the period 1968-1987. The Consumer Expenditure Survey (CEX) has limited information on employment changes but high quality quarterly data on all types of consumption for 1979-1991. The goal is to use these two sources, with their different advantages and weaknesses, to paint a broad picture of the effect of UI. This paper builds on earlier analysis in Gruber (1994), where I found a significant consumption smoothing effect for food consumption only in the PSID, by examining a variety of different types of consumption.

To summarize, I find that UI plays a significant consumption smoothing role in both the PSID and the CEX. In the PSID, I find that, in the absence of UI, there would be very sizeable falls in expenditures on necessities such as food and housing. In the CEX, I find a smaller (but still significant) effect on total consumption. Furthermore, this fall in total consumption is driven by changes in spending on non-necessities; expenditures on food and housing are not very responsive to UI benefits variation in this dataset. Thus, while both data sets suggest that there are benefits to increasing UI benefits generosity, the CEX suggests that these benefits are much more limited than does the PSID. This conclusion, however, is tempered by a number of problems in defining spells of unemployment in the CEX.

The CEX results suggest that individuals have other insurance which they are using to help smooth their consumption during unemployment spells. In the final section of the paper, I investigate this contention directly, by looking at the interaction of UI and five forms of other insurance: the labor supply of spouses; transfers from relatives; food stamps; total transfer income;

and savings. While there is some evidence that UI is crowding out use of food stamps, the net effect on other forms of insurance is quite small, which is consistent with the PSID finding that UI plays a large role in smoothing consumption.

The paper proceeds as follows. In the first section, I present the theoretical arguments for and against a consumption smoothing role of unemployment insurance. In Part II, I discuss previous evidence on consumption during unemployment. In Part III, I discuss the PSID data and the empirical specification, and present the PSID results. Part IV does the same with the CEX data. Part V looks at the interaction between UI and other forms of insurance. Part VI concludes.

Part I: Theoretical Background

As noted above, one traditional justification for public unemployment insurance is that it provides a means of smoothing individual consumption across the risky event of unemployment. Private unemployment insurance could provide the same function, but, due to problems such as adverse selection, private consumption insurance markets for spells of unemployment may not exist. Individuals can save for unemployment, but this is less efficient than insuring against such a risky event, since individuals who do not end up losing their job are inefficiently reducing today's consumption. Insurance markets overcome this inefficiency by pooling the risk across individuals who do and do not lose their jobs. Thus, the provision of public unemployment insurance may raise welfare by filling the missing market for a state-contingent payment. The optimal size of the program will trade off these consumption smoothing gains against the induced distortions to individual and firm behavior.

A useful starting point for modelling the effects of UI on consumption during unemployment is the optimal benefits model of Baily (1978). Baily's two-period model considers individuals who

make consumption and savings decisions in the first period, subject to a level of UI taxes and an exogenous probability of layoff, and make consumption and duration of unemployment decisions in the second period, subject to a level of UI benefits. The individual maximizes:

(1) $V = U[y(1-t) - s] + \alpha * U[y(1-t) + s] + (1-\alpha) * U[y_l + s]$

where α is the probability of remaining employed, so that $(1-\alpha)$ is the probability of losing the original job. The net amount of savings is s. Earnings on the original job are y, and earnings if the individual becomes unemployed for some fraction of the second year are:

(2) $y_l = (1-\beta)(b-c) + \beta y_n(1-t)$

where $(1-\beta)$ is the fraction of the year unemployed, b is the unemployment insurance benefit, c is search costs, and y_n is the earnings on the new job. Unemployment insurance is financed by a tax t. The model is closed by a UI budget constraint which sets the aggregate level of benefits and taxes equal:

(3) $yt + (1-\alpha)yt + \alpha\beta y_n t = \alpha(1-\beta)b$

This model can readily be used to illustrate the consumption smoothing gains from introducing a public UI system in the absence of private unemployment insurance. To do so, I consider the simplified case of Cobb-Douglas utility, exogenous search behavior with no search costs, and a post-unemployment wage equal to the pre-unemployment wage ($y_n=y$).[2] I first solve the model for the optimal level of savings s^*, given the UI replacement rate. I then use s^* to calculate the effect of increasing UI generosity on consumption smoothing, defined as the percentage change in consumption from period 1 to period 2 for an individual who becomes unemployed for β

[2]The fixed unemployment duration (β) is assumed to be 14.4 weeks, the average in my PSID sample for those who spend at least one week unemployed. Allowing duration to be endogenous to the level of benefit mitigates the consumption smoothing result presented below, since longer duration leads to a lower total income in the second period, reducing the extent of consumption smoothing.

weeks in period 2.

The results of this calculation are expressed graphically in Figure 1, for probabilities of layoff of 1%, 25%, and 50%. Each point in Figure 1 represents the percentage fall in consumption for the individual becoming unemployed. In each case, there is a sizeable drop in consumption with no unemployment insurance; for a probability of layoff of 1%, the drop is approximately 20%. However, introducing public unemployment insurance mitigates this fall. This consumption smoothing effect increases with the generosity of UI, until consumption is unchanged at a 100% replacement rate. This figure yields the key prediction that will be tested below: *consumption will fall with unemployment in the absence of UI, but this fall will be mitigated as UI generosity increases.*

The consumption smoothing effect of UI shown in this simplified model will be a function of a number of factors in reality. One such factor is the extent to which unemployment is anticipated by the worker. In Figure 1, as the probability of layoff rises, the initial consumption fall is reduced, and UI has a smaller consumption smoothing effect. This is because the efficiency of the savings mechanism increases as unemployment becomes a more likely event; with perfect certainty, savings is fully efficient and UI has no effect.

Another is the nature of the worker's preferences. For example, if workers are myopic, the consumption smoothing effects of UI will be larger than those depicted in a model with savings for unemployment spells. On the other hand, if individuals are forward looking, as the number of periods of employment rises relative to the number of periods unemployed, then savings becomes a more efficient smoothing mechanism and UI will have a smaller effect. Even in the limit, however, smoothing across the (relatively) small number of periods of life is inferior to smoothing across a large pool of workers.

Furthermore, even with very forward looking workers, there may be considerable capital market constraints faced by the worker carrying out her planned lifetime consumption path. Consider an individual who faces a known probability of unemployment in one period of a many period life, but the timing of this spell is unknown. If the individual can borrow, she can smooth this small consumption fall over her entire lifetime; public UI will only have a very small consumption smoothing effect through risk-sharing in this case. If she cannot borrow, however, then she may not have accumulated sufficient assets to smooth her consumption during the unemployment spell, and UI may have a much bigger effect. There is some limited evidence on the savings behavior of the unemployed in the PSID, which collected information on individual wealth holdings in 1984. Among individuals who lost their job between the 1984 and 1985 interviews, only 35% had positive net liquid assets before the job loss, and only 12.5% had savings of more than 2 months income. The comparable figures for those not losing their jobs were 49% and 24%, respectively.

The final key factor will be the extent of consumption insurance available from other sources. One example is the labor supply of family members. There is a small literature which measures the "added worker effect" when the primary earner becomes unemployed, but there is little evidence that this response is quantitatively important (Lundberg, 1985; Mahoney, 1990). Furthermore, pooling labor supply among a small set of family members is once again inefficient relative to pooling the risk of unemployment across a large number of workers. Another example is private unemployment insurance arrangements, such as supplemental unemployment insurance benefits through employers. But only 5% of workers worked for employers which offered supplemental unemployment benefits in 1989 (Employee Benefits Research Institute, 1992), and only 6% of individuals who spent at least one week unemployed received such benefits in 1988 (author's calculations using data from the March 1989 Current Population Survey).

To summarize, the net effect of unemployment insurance generosity on consumption during unemployment is a function of a variety of factors. Past research offers only a rudimentary understanding of each of these factors individually, and little evidence on their interaction. Thus, the consumption smoothing effect of UI remains an empirical question.

Part II: Consumption During Unemployment

There is a small literature which documents the effect of unemployment spells on consumption. The classic work in the U.S. is Kingston *et al.* (1978) and Burgess *et al.* (1981), who evaluated the consumption change during the first six months of unemployment for a sample of unemployment insurance claimants in Arizona. They found that two-thirds of unemployed households reduced their expenditures from the month prior to job loss to the month prior to the 13th week of unemployment. The average household reduced its expenditures by 15.2%, and 40% of households reduced their expenditures by 20% or more. But these expenditure reductions were greatly mitigated by more generous UI benefits. For those with replacement rates below 50%, expenditure fell by 30%; for those with replacement rates above 86%, expenditures were unchanged. There was also substantial variation in the response of different types of consumption: "necessary and obligated expenditures" such as those on food and housing fell by 30% for those with replacement rates below 50%, but these expenditures actually rose by 10% for those with replacement rates above 86%.

These results provide very suggestive evidence that UI plays an important consumption smoothing role. But this study has two key weaknesses. First, the data are for UI claimants only. Since takeup of UI benefits is endogenous, it may be that only those unemployed with the most severe spells are availing themselves of these benefits. For example, if there is some stigma

associated with receipt of UI, then individuals who face only a short layoff, and thus may only see a small proportionate change in their consumption, will not takeup UI benefits. This would lead to an upward bias to the estimated consumption fall from unemployment. It will also likely lead to an upward bias to the estimated consumption smoothing effect of UI. Since takeup has been shown by Blank and Card (1991) to be a function of benefit levels, it could be that only those with severe spells takeup UI at low replacement rates, and those with less severe spells takeup UI at high replacement rates. This would lead to a bias in favor of finding a consumption smoothing effect, since high replacement rates would be associated with a smaller consumption fall.

Second, the variation in UI replacement rates is solely driven by differences in ex ante earnings levels. These differences may be correlated with other determinants of consumption smoothing, ie. savings behavior. In this case, the likely bias is against finding a consumption smoothing effect of UI, since higher wage earners are more likely to have savings and thus there should be a smaller consumption fall during the unemployment spell regardless of UI generosity levels. Since these higher wage earners have a lower replacement rate, there will be a (spurious) negative association between the replacement rate and consumption changes.

A similar study of UI claimants was carried out in the U.K., and the results are reported in Heady and Smyth (1990). This survey gathered qualitative data on ownership of a number of household durables, consumption of food and clothing, and the condition of housing. The authors found that there was little change in the stock of durables upon unemployment, but that there were significant falls in consumption of necessities such as food, clothing, and housing. They do not, however, provide any information on the role that UI played in smoothing consumption changes. Furthermore, this study considered only individuals who claimed unemployment benefits and who were out of work for three months of more, so the type of selection bias documented above is even

more important in this context.

Previous work using food consumption in the PSID includes Shefrin (1987) and Cochrane (1991), both of whom find that consumption falls significantly during spells of unemployment. However, neither test provides a definitive rejection of the null of "full consumption insurance" posed by Cochrane, for two reasons. First, leisure may rise during spells of unemployment, and if leisure and consumption are substitutes, then consumption will fall even if there is full insurance. Second, utility may be state-dependent; that is, even if leisure is unchanged, the marginal utility of a given level of consumption may be lower when unemployed.[3] No test of full consumption insurance which compares consumption across two different states can convincingly surmount these fundamental identification problems. Thus, whether there is scope for consumption smoothing by UI remains an empirical question.

On the other hand, the analysis performed here provides the correct comparative static exercise for testing for the presence of full consumption insurance. If such insurance exists, then we should see no effect of increased UI generosity on consumption smoothing; UI increases should simply crowd out other sources of consumption insurance. By examining the effect of changes in UI generosity among workers in the same state (unemployed), this test controls for state dependence in assessing the extent of consumption insurance.[4]

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[3]See Viscusi and Evans (1990) for evidence of the dependence of marginal utility on health states. Cochrane notes that these are potential problems with his approach; he assumes that the social planner possesses some extra-market institution through which leisure can be transferred, and that there is not state dependence.

[4]A test of this nature is carried out by Hausman and Paquette (1987), who measure the consumption change of involuntary early retirees relative to that of voluntary retirees. If involuntary retirement is truly exogenous, then they surmount the state dependence problem by focusing only on individuals who have retired. They find a strong relative fall in the consumption of involuntary retirees, rejecting full consumption insurance along this dimension.

Further direct evidence on the role of UI is provided by Hamermesh (1982), who examines whether the marginal propensity to consume out of UI benefits is equal to the marginal propensity to consume out of other income. He takes his rejection of this null as evidence that individuals are liquidity constrained during unemployment spells, justifying the provision of public unemployment insurance. His cross-sectional test, however, is performed by comparing individuals who receive UI to those who do not. A problem with this approach is that individuals receiving UI may differ in a number of ways from those not receiving UI, not the least of which is the fact that they are unemployed. A stronger test would be to compare two individuals, both of whom are unemployed, and assess whether increasing the UI available to one, relative to the other, increases her relative consumption. This is the spirit of the test carried out below.[5]

Finally, in earlier work I have examined the effect of variation in UI benefits on consumption changes during unemployment (Gruber, 1994). I found that there was a significant consumption smoothing effect of UI; my estimates implied that the fall in consumption for the typical unemployed person would have been over three times as large in the absence of UI as it is given average program generosity. But a potential limitation of that earlier study was that it only relied on food consumption data in the PSID, which may misstate the total consumption smoothing effect of unemployment insurance for two reasons. First, the elasticity of food demand with respect to short run income shocks might be quite different than the elasticity of demand for other types of consumption. Second, even if food and other types of consumption respond commensurately to changes in income in the short run, there may be differential complementarities between leisure (which is presumably increasing for the unemployed) and consumption of different good. This point is highlighted by

[5]Dynarski and Shefrin also include UI benefits received in their model, and they find a positive but insignificant effect of benefits on consumption changes. However, as noted above, this test has the problematic feature that takeup of UI is endogenous.

Meghir and Weber (1993), who find evidence of a significant difference in the complementarity between leisure and food consumption versus leisure and other types of consumption. The resulting bias to the estimates in Gruber (1994) is unclear ex ante, although the evidence from Burgess *et al.* (1981) suggests that there is an understatement of the consumption smoothing effect from using food only.[6] So it is clearly important to move beyond food consumption alone and examine the broader effects of UI on the total consumption bundle.

Part III: PSID Consumption Analysis

Data

The first set of data to be used for assessing the consumption smoothing effects of UI are the Panel Study of Income Dynamics. This longitudinal survey has been carried out continuously since 1968, following the same sample of families and their "split-offs" over time. The original sample consisted of a nationally representative cross-section and a sub-sample of families in poverty; in the analysis below I use both samples in order to increase the precision of the estimates.

The PSID is the only longitudinal data set available with both information on prime age workers and measures of consumption.[7] This advantage, however, is tempered by the limited nature of the consumption data available. The primary measure of consumption which has been used in previous research derives from questions about how much the family "usually" spend on food at

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[6]For those with replacement rates below 50%, food consumption fell by 23% and total consumption by 30%; for those with replacement rates above 86%, food consumption rose by 2% and total consumption was unchanged. Thus, the effect of increasing the replacement rate on food consumption was smaller than on total consumption.

[7]The other longitudinal data set with consumption information is the Retirement History Survey, which is used by Hamermesh (1984) and Hausman and Paquette (1987). However, this survey covers both a shorter time frame (1969-79 only), and collects data only on those from the ages of 58-63 in 1969.

home and food away from home. These food data have been widely used in tests of the applicability of the life-cycle model of consumption (ie. Hall and Mishkin, 1982) and the presence of liquidity constraints (Zeldes, 1989; Engelhardt, 1993), as well as in the papers described above by Dynarski and Shefrin (1987) and Cochrane (1991). But the limitations of using food alone, as in Gruber (1994), are described above.

As emphasized by Skinner (1987), however, there is actually a richer variety of consumption data in the PSID besides food consumption. In particular, there are two questions on housing consumption: annual housing expenditures (mortgage payments for owners and rental payments for renters); and whether the individual is an owner or a renter. These additional variables can be used to extend my earlier analysis to housing expenditures. In the analysis of Burgess *et al.*, housing was the category that adjusted the least to variations in UI generosity. So, by examining housing in the PSID, we can hopefully provide a lower bound on the consumption smoothing effects of UI.

Food consumption is defined as the sum of consumption at home, away, and paid for by food stamps. I deflate each component of food consumption by the CPI for that component in the month of the interview, and then sum the real components. I use a monthly rental cost deflator to deflate mortgage expenditures and rental payments. I exclude observations where any element of consumption is imputed, rather than reported directly by the respondent. In some specifications, I also trim the outlying 2% of consumption change observations; this is discussed further below. All of the consumption questions used refer to the point of the interview.[8] I therefore use employment status at the time of the interview as my key independent variable in testing for consumption smoothing.

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[8]The timing of the food expenditure questions is actually unclear; see Gruber (1994) for a detailed justification of my timing assumption.

The sample consists of all heads of household for each year of the PSID from 1968-1987. Data on food consumption were not gathered in 1973, and data on housing are missing in 1973-1975. There is one observation for each person/year in which an individual is employed at the previous interview. Individuals are defined as unemployed if they are looking for a new job, but are not on temporary layoff. Temporary layoffs are excluded because the information about both probabilities of both layoff and recall to the same job may be quite different for this population. As noted with relation to Figure 1, individuals who anticipate their layoffs may see a smaller consumption smoothing effect of UI, and being on temporary layoff is highly correlated with recall to the same job and therefore (most likely) with anticipation of the unemployment spell. In Gruber (1994), I show that the consumption smoothing effect of UI is much smaller for temporary layoffs.

Specification

My initial specification is run on individuals who are employed at interview date t-1 and unemployed at interview date t.[9] For these individuals, I run regressions of the form:

$$(4) \qquad \Delta C_i = \alpha + \beta_1 X_i + \beta_2 UI_i + \epsilon_i$$

ΔC is the change in (log) consumption when the individual becomes unemployed, X is a vector of individual characteristics which may affect the consumption change, and UI measures the replacement rate (ratio of benefits to wages) for which an individual is *eligible*. The hypothesis that UI is having a consumption smoothing effect is tested by a finding of $\beta_2 > 0$.

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[9]Selecting the sample in this way leads to a potential sample selection bias, as previous research (Feldstein (1978), Topel (1983)) has shown that the probability that an individual is laid off is a function of the replacement rate. This is potentially problematic for my approach, if the individuals who are laid off when replacement rates rise are systematically different from other layoffs. As I show in Gruber (1994), however, there is no correlation between inclusion in my sample of unemployed and the level of UI benefits. This finding does not contradict the conclusions of the earlier literature, due to the exclusion of temporary layoffs from the sample.

The set of exogenous control variables used in the basic specification includes the age, sex, marital status, race (white, black, other), and education of the head, the number of children in the family, and the change in the log of the "food needs" of the family, which is a combination of family size and age (calculated by the PSID). I also include separate dummies for each year to capture time trends in consumption changes.[10]

The key regressor is the UI benefits for which an individual is eligible. To create this variable, I have built a simulation program which models each state's UI system for the period 1968-1987. The basis for this program is Employment and Training Administration (various years), which reports biannual information on state benefit schedules. In addition, it was augmented by information from a number of states and from Levine (1990). UI benefits are generally calculated as a function of the individual's highest quarter of earnings in some base period (ie. last five quarters), along with information on the number of dependents (in some states). Since quarterly earnings information is not available, I use the average weekly earnings in the year preceding the t-1 (employed) observation. UI benefits are then divided by this weekly earnings variable to calculate the replacement rate; after tax real wages are also included as a control variable to capture any spurious correlation between wages and consumption.[11]

The appropriate measure of the extent of wage replacement must account for the fact that UI

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[10]Other natural candidates for control variables include wealth and the labor supply of other family members. However, these variables are potentially endogenous to UI benefit levels. As shown in Gruber (1994), the results are robust to the inclusion of state effects and controls for the state/year and county/year unemployment rate. The CEX results below are also robust to these controls. Food needs are calculated by the PSID by summing age and sex specific food costs for each family member, then adjusting the total by an equivalence scale for family size.

[11]In order to qualify for UI, individuals must have a (state-specific) minimum level of earnings. To approximate this eligibility criterion, I drop any observation where weekly wages were below the weekly minimum UI benefit for that state and year.

benefits are subsidized by the U.S. tax system. Before 1979, benefits were not taxed under either the income tax or Social Security tax, while wages were taxed under both, so I multiply the replacement rate by: $\frac{1}{(1-\tau-\tau_{ss})}$, where τ is the income tax rate, and τ_{ss} is the social security tax rate. From 1979 through 1986, benefits were subject to income tax above certain income cutoffs,[12] so that the replacement rate is only multiplied by the Social Security adjustment; this was true at all income levels for 1987 onward. Finally, for those above the Social Security taxable maximum in any given year, there is no Social Security adjustment.[13]

The output of the UI benefit simulation model is reported in Table A1, which reports after-tax replacement rates for each state for 1969, 1979, and 1987, as well as the change from 1969 to 1987 and from 1979 to 1987. A number of states are missing in the early years, owing to the smaller sample size of the original PSID cohort. There is a large amount of variation in UI replacement rates across states and over time.[14] There is a strong secular decline in benefit generosity over this period; on average, after-tax replacement rates fall by 13.5 percentage points (23.5%). The decline varies across states, however: Arkansas saw a decline of 33 percentage points in the average replacement rate from 1969-1987, while the replacement rate actually rose in Minnesota, North Dakota, Oklahoma, and Oregon.

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[12]The cutoffs were $20,000 for singles and $25,000 for marrieds from 1979-81, and $12,000 for singles and $18,000 for marrieds from 1982-86.

[13]The PSID reports marginal income tax rates for respondents from 1976 onwards. From 1970-75, the PSID does not report tax rates, but does report taxes paid; following Zeldes (1989), I use the tax tables for each of those years, along with information on marital status, to calculate the marginal rate. For 1968 and 1969, I use information on taxable income, number of dependents, and marital status to calculate the tax rate.

[14]This variation reflects differences in both individual characteristics and state/year legislative environments. I will present an instrumental variables strategy below for separating these two components of replacement rate variation.

The means and standard deviations of the data set are presented in Table 1, for the full sample of individuals employed at t-1, those who remain employed, and those who become unemployed. Those who become unemployed have a much lower real wage and consumption level in the previous period (according to both food and housing consumption), are more likely to be female and black, and are less likely to be highly educated or married. Most importantly from the perspective of this paper, unemployment is associated with an average drop in food consumption of 7.6% and in housing consumption of 4.6%. Remaining employed has a small positive effect on food consumption, and a larger positive effect on housing consumption.

Results

The results of estimating equation (4) are presented in Table 2, for several different measures of consumption. In the first column, I replicate the food consumption results of Gruber (1994).[15] As in that paper, there is a significant and sizeable positive coefficient on the after-tax replacement rate, indicating that a 10% rise in the replacement rate reduces the fall in consumption upon unemployment by 2.71%. Furthermore, I find that the fall in consumption for those becoming unemployed, at a replacement rate of zero, is 23.3%. That is, in the absence of UI, becoming unemployed would be associated with a fall in consumption *over three times as large* as the 7.6% average drop reported in Table 1. But, at a replacement rate above 86%, UI fully smooths consumption across the unemployment spell.[16]

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[15]The results are slightly different than in my earlier paper, because I trim outliers in a different way. In that paper, I excluded any observation with a log change greater than 1.1; here, I exclude the outlying two percent of observations, which results in a slightly larger sample size. The sensitivity of the analysis to outliers is discussed further below.

[16]These predictions are not grossly out of sample; 90% of the sample has replacement rates within the range of 20% to 80%.

In the second column, I use annual payments for rent and mortgage as the dependent variable. The consumption smoothing effect here is even larger than for food, in contrast to the Burgess *et al.* findings. The implied drop in consumption at a zero replacement rate is smaller, however, so that for replacement rates above 69% housing consumption is actually rising upon unemployment.

It is important to note at this point that the implied result that consumption could actually *rise* if UI fully replaced previous wages is not an implausible one. This could arise, for example, if leisure and consumption were complements, or if there was some other related form of state dependence in consumption.

The third column models the effect of UI on the probability that the individual sells his or her house. The regression is run as a probit; the implied marginal probability is in square brackets. The coefficient is negative, and indicates that every 10% replacement rate rise lowers the probability of selling one's house by 0.19%. The implied probability of selling one's house in the absence of UI is 5%. The mean probability of selling for those who become unemployed is only 3%, so the results suggest that the presence of the UI system lowers the probability of selling by almost one-half.

In Table 3, I explore these measures of consumption in more detail. I present two results for each dependent variable: results which drop the outlying 2% of observations (paralleling Table 2), and results which do not drop outliers. It is not obvious ex ante whether outliers should be dropped; they may contain real information on particularly bad outcomes which are affected by the UI system. On the other hand, data on consumption changes are notoriously noisy so it would be distressing if the results were driven by several poorly reported observations. I report just the coefficient of interest from regressions such as those in Table 2; each coefficient is from a distinct

regression.

The first row repeats the analysis of food consumption from Table 2. In this case, including outliers significantly increases the consumption smoothing effect of UI, as well as the drop in consumption in the absence of UI, which is now almost four times as large as the average drop reported in Table 1.

The next two rows examine the different components of consumption, where food consumed at home includes food stamps; we present results below where food stamps are excluded. One hypothesis for the estimated consumption smoothing role of UI could be that individuals are switching from restaurant meals to home meals when unemployed, lowering their expenditure on food but maintaining their total level of consumption, and that more generous UI simply mitigates this compositional shift. If this is the case, then the response of food away from home to unemployment and UI generosity should be much larger than the response of food at home. In fact, the estimates for food at home and food away from home are in the same range, although the coefficient for food away is somewhat larger. This contradicts the hypothesis that individuals are simply shifting the site of their consumption.

The next three rows explore the finding for housing consumption in more detail. For overall housing consumption, the estimated consumption smoothing effect actually falls somewhat if outliers are included. The effects on rental payments and mortgage payments are roughly similar; the relative ranking of the coefficients is dependent on the inclusion of outliers, but in no case are the individual coefficients significant. The fact that mortgage payments respond as strongly to UI generosity as rental payments may reflect the negative effect of UI generosity on the probability of selling one's house shown in Table 2.

Thus, to summarize the PSID findings, there is a significant and sizeable consumption

smoothing role for UI. The findings reported in my earlier work for food are borne out by housing. The results therefore suggest that UI plays a very important role in smoothing the consumption of necessities by the unemployed.

Part IV: CEX Analysis

Data

While the analysis above was able to move beyond food consumption, the consumption data in the PSID remain quite limited. Thus, I turn next to broader consumption data in the Consumer Expenditure Survey. This survey collects information on households for five consecutive quarters. Baseline information on respondents is collected in the first interview, and the remaining four interviews gather information on several hundred categories of consumption. In both the second and fifth interviews, information is also gathered on income and employment, thus offering the potential for a longitudinal aspect to the survey by comparing the results three quarters apart. Data is available for approximately 5000 families for each year from 1980 to 1991.

The advantage of this survey is clearly the richness of detail in measured consumption. The disadvantage, however, is that there is not comparable information to the PSID on changes in employment status. Information on employment status, weeks worked in the previous year, and earnings are collected in the second interview, and information on weeks worked in the previous year and earnings are collected in the fifth interview. But there is no information on employment status at the point of the fifth interview, making it impossible to replicate the PSID analysis. Furthermore, there are no questions on unemployment per se; the employment status question in the second interview simply measures whether the individual is employed or not, and there is no measure of weeks unemployed last year, only weeks worked.

There are two possible solutions to this data deficiency. The first is to do a cross-sectional analysis at the point of the second interview, using the question on employment status. This approach has two weaknesses, however. First, a number of the non-working may not be unemployed, but rather out of the labor force. Second, UI benefits are a function of pre-unemployment earnings, but I have no information on the pre-unemployment period. It is clearly problematic to use earnings from the period when the individual is out of work to calculate potential UI benefits.

The second solution, which I adopt, is to infer employment changes from the second to fifth interview. I do so by conditioning on individuals who report themselves at the second interview to be employed and report working at least 48 weeks in the previous year. These individuals are then labelled employed at the fifth interview if they report working at least 48 weeks in the previous year, and they are labelled unemployed if they report working less than 48 weeks in the previous year. In this way, I can both measure a change in employment status and obtain a pre-unemployment measure of earnings.

This methodology has a number of potential problems. First, there will be some employment status transitions which are not the result of unemployment, but other labor force changes. I minimize this problem by only including individuals aged 18-64 in my CEX sample. Nevertheless, while only 3.4% of individuals became unemployed from 1980-1987 according to my PSID definition, four times as many individuals became unemployed from 1980-1987 using my CEX definition.

One means of identifying how many of these individuals were truly unemployed is to look at information on UI receipt in the last year, which is reported in the fifth interview. Of those becoming unemployed by my CEX definition, 23.4% report receiving some UI during the previous

year. In the PSID, the comparable figure is 39.2%. So, at most, the CEX results are understated by approximately 40% relative to the results reported earlier.

Second, there is the sample selection problem noted above: if becoming unemployed is a function of UI generosity, then more generous benefit levels may affect consumption by changing the composition of the pool of unemployed. I presented evidence above that this was not a problem in the PSID. However, it is more likely to be problem in the CEX, since my definition hinges on weeks of unemployment, and Meyer (1990) and others have shown that unemployment durations are dependent on UI benefits. Indeed, there is a significant positive relationship between the probability of becoming unemployed (by my definition) in the CEX and the after-tax replacement rate. The bias that this imparts to my estimates is not obvious; it is a function of the differences in consumption behavior of the person induced to become unemployed by generous UI, versus the average consumption of the otherwise (exogenously) unemployed.

Finally, there is the problem of mistiming in my consumption data. I will measure consumption in the quarter preceding the second and fifth interviews. While the method used above guarantees that the individual is employed at the second interview, there is no guarantee that the individual is actually unemployed at the fifth interview; they could have been unemployed at some other time in the previous year, and reemployed by the point of the fifth interview. I have attempted to mitigate this problem by defining unemployment as working less than 12 weeks in the previous year, which would raise the probability that the individual was actually unemployed at the fifth interview. Despite reducing the sample size somewhat, this had little effect on the results, so I only report the results below using the 48 week cutoff.

The after-tax UI replacement rate is measured in the same manner as in the PSID.[17] Tax rates are calculated using information on individuals' before-tax family income and family structure. Weekly earnings before unemployment are calculated as annual earnings divided by weeks worked in the year preceding the second interview. The control variables are generally the same as those used in the PSID analysis, except that change in family food needs was not available, so that change in family size was used instead.

I use a number of different measures of consumption, which are aggregated from the many categories of consumption reported in the CEX. In each case, the consumption measure is deflated by the appropriate CPI deflator for that good in the month of the interview. The sample consists of household heads who were included in the survey in both the second and fifth interviews, and who were employed (as defined above) at the second interview and unemployed at the fifth.

The means for the CEX are reported in Table 4; the quarterly consumption measures have been converted to annual dollar amounts for comparison to the PSID. Total consumption in a given year for the full sample is slightly over $22,000; as in the PSID, consumption in the period before unemployment is lower for those who become unemployed. I divide total consumption into consumption of "necessities" (food,[18] rental and mortgage payments, and utilities payments) and "non-necessities" (total consumption minus necessities). Note that for those becoming unemployed, prior consumption is slightly tilted towards necessities (42% of consumption vs. 40% of consumption for those who do not become unemployed). Annualized food consumption, not reported here, is approximately $3800 for the full sample, and $3560 for those becoming unemployed, which matches

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[17]State of residence is generally not reported on the CEX, but it was attached by special request to the Bureau of Labor Statistics.

[18]Note that food consumption excludes alcoholic beverages, which are included in a separate category below.

the PSID numbers in Table 1 quite closely.

The sample differs somewhat from the PSID in demographic composition (more female, less black), but those becoming unemployed differ from those remaining employed in similar ways (more black, less education, lower earnings). The average consumption change among those becoming unemployed is much lower in the CEX than in the PSID. The change in non-necessities is larger than the change in necessities, which suggests that the response of the consumption bundle to short run shocks is similar to the response to longer run income changes (since the Engel curves for necessities are well-known to be flatter than the Engel curves for non-necessities).

Results

The CEX regression results for total consumption, necessities, and non-necessities are presented in Table 5. The results for total consumption are significant at the 6% level, and suggest that a 10% rise in the replacement rate is associated with a 1.3% reduction in the consumption fall upon unemployment. The implied consumption fall with a zero replacement rate, 8.8%, is only about 1/3 of the implied fall in food consumption in the PSID. As noted above, however, there are a number of reasons to expect this finding to be lower than that in the PSID, such as the fact that fewer of these transitions are true moves to unemployment and the fact that the unemployment spell may have ended by the point of the fifth interview. Adjusting for the former bias using data on likelihood of UI receipt raises the point estimate on the replacement rate to 0.218, which is more similar to the estimates from the PSID.

The next two columns suggest that the effect of UI on consumption of non-necessities is much larger than the effect on necessities. For necessities, there is an insignificant effect of UI on consumption, and virtually no implied fall in consumption in the absence of a UI system. But for

non-necessities, there is a large consumption smoothing effect, on the same order of magnitude as that uncovered for food consumption in the PSID.

In Table 6, I show the results for a variety of categories of consumption, once again both with and without outliers. The results for total consumption are stronger once outliers are included; this appears to be driven by a doubling of the necessities coefficient. The next row reports the results for food consumption, which differ dramatically from the PSID; there is only a small and insignificant consumption smoothing effect. This is somewhat larger when outliers are not excluded, but it remains much below the finding from the PSID. Furthermore, also in contrast to the PSID, the consumption smoothing effect on food away from home is much stronger than the effect on food at home.

The results for rent and mortgage payments, when outliers are excluded, is also quite different from the PSID. When outliers are included, however, the results are more in line with the earlier findings. There is little effect on expenditures on utilities.

The results for clothing are quite surprising: there is a negative and sizeable coefficient on the after-tax replacement rate. The results suggest that consumption of clothing would actually rise in the absence of UI, but that more generous UI lowers spending on clothing. This result may reflect a substitution of clothing for other goods when UI is not generous. This could be due, for example, to increased job search (thus requiring new clothes) when UI is less generous. For car services and parts, there is a positive, and moderately sizeable (especially if outliers are included) consumption smoothing effect.

The largest smoothing effect of UI is reported in the next two rows, for housing durables and

services, and for entertainment.[19] In both cases, there is a coefficient of approximately 0.3. But there is an interesting difference between the categories in terms of the implied reaction of consumption in the absence of UI. For housing services and durables, there is a large implied fall; excluding outliers, in the absence of UI consumption would fall by over 37%. But for entertainment, there is actually an implied *rise* in consumption in the absence of UI, and more generous UI simply serves to further increase consumption. In fact, for the average person becoming unemployed, consumption of entertainment services rises by 21%! This almost certainly reflects a complementarity between this type of consumption and leisure.

Finally, does UI smooth consumption of "bads" such as alcohol and tobacco? If much of the effect of UI was on consumption of such "bads", it could justify a reduction, rather than an increase, in UI generosity. In fact, however, there is little effect on alcohol and tobacco consumption from higher UI replacement rates (although the results without outliers are of the same order of magnitude as for food consumption).

Part V: UI and Other Forms of Insurance

The findings in Part III and Part IV offer one general lesson: UI plays a sizeable and significant role in smoothing the consumption of the unemployed. However, the magnitude of this role varies substantially between the two datasets. The difference between these two sets of results has important implications for the availability of other forms of insurance for the unemployed person who is attempting to smooth his consumption. For example, for food consumption in the PSID, the results imply that consumption would fall of 23.3% in the absence of UI. Since individuals are only

[19]If the regression is estimated separately for housing services and housing durables, there are large positive coefficients for both sub-categories.

unemployed for 14.4 weeks on average, this is an 84.1% consumption drop on a full year basis. So, due to savings, borrowing, or other consumption insurance, individuals would be able to smooth consumption by only 16% in the absence of UI.

The CEX, on the other hand, implies that other sources of consumption insurance are much more complete than does the PSID. Using total consumption, the annual 8.8% implied fall in consumption in the absence of UI amounts to only a 21% consumption fall during the period when individuals are unemployed. It is important to highlight that this finding is tempered by the inability to satisfactorily define employment changes in the CEX. But adjusting the result to the same basis as the PSID (using information on UI receipt) only raises the consumption drop during the unemployment period to 35%. Thus, the CEX findings suggest that other sources of consumption insurance may be able to smooth consumption by as much as 65%, even if there were no unemployment insurance.

These disparate conclusions as to the extent of other consumption insurance for unemployment spells suggests the value of directly investigating the interaction between UI and these other forms of insurance. We do so by focusing on five potential sources of insurance for unemployment spells. The first is the labor supply of wives (since all of the female heads in our sample are single, the only spouses are wives). As noted above, the literature on the "added worker effect" suggests that there is little spousal labor supply response to unemployment spells. However, this small response may mask an underlying larger response which is crowded out by UI, much as the small mean PSID food consumption drop in Table 1 masks the larger consumption drop which would occur in the absence of UI. We measure labor supply by the earnings of the wife. One problem with this measure, as well as with the other annual dollar measures used below, is mistiming; unemployment is measured at the point of the interview, while spousal labor supply is

measured for the year preceding the interview. I therefore use an average of spousal earnings in the year before the interview and the year of the interview in the analysis; the answers are similar if data from the year before only are used. I also use another measure of spousal labor supply which does not suffer from this mistiming problem: a dummy for whether the wife was not working at the previous interview, but is working at the current interview (the inverse of the measure of employment change used for the head).

The second measure of insurance is transfers from relatives. The third measure is total (non-UI) transfers, which includes transfers from relatives as well as other government support. I subtract out UI to remove an obvious positive bias from more generous benefits eligibility leading to more generous benefits receipt.[20] The fourth measure focuses directly on one public transfer program: food stamps, a means-tested program which subsidizes the purchase of food. The consumption measure used thus far incorporates consumption paid for by food stamps. By comparing results with and without food stamps, I can assess the extent to which food stamps interact with UI in smoothing consumption.

Finally, I look at the interaction between UI and wealth accumulation. One form of insurance that can be crowded out by UI is individual savings. As noted above, savings is a less efficient means of insurance than is UI, but it may be the most natural alternative. The PSID collected data in 1984 and 1989 on wealth holdings of individuals. I use two measures of wealth: gross financial and net financial wealth. The former consists of interest earning assets in banking and other institutions, household equity in stocks and mutual funds, and other assets such as bonds and checking accounts; the latter subtracts off unsecured debt from this total. While the latter is

[20]Before 1977, however, UI receipt is lumped together with workers compensation insurance receipt, so this measure will subtract out some other transfer income as well.

theoretically appropriate, it has the problem that debt holding may indicate either financial constraint or, alternatively, access to debt markets. That is, an individual with slightly negative net assets may be in a better financial situation than one with slightly positive net assets, if the latter person does not have access to unsecured sources of borrowing while the former does.

The results are reported in Table 7. For the measures of insurance which are in changes, I present the change in the dollar level (rather than log), since many of the observations are zero; the inferences are similar if logs are used. For wife's labor supply, there is some evidence of a crowding out effect of UI, although neither of the estimates are significant. As UI is more generous, the wife's earnings increase less, and she is less likely to go to work. In order to scale this finding, note that the average person becoming unemployed has an average weekly wage of $211, so that a 10% rise in the replacement rate would increase weekly UI benefits by $21. This same 10% rise is implied to lower the wife's annual earnings by $25, which amounts to slightly more than one week's incremental rise in the benefits from the 10% replacement rate rise. Compared to an average unemployment spell of 14.4 weeks in my sample (so that total annual benefits would be rising by $302), this is a very small response.

Transfers from relatives and total transfers, on the other hand, do not appear to be crowded out by UI. In fact, total transfers rise as UI gets more generous, although the estimate is not significant. This rise could be do to correlations across states between the generosity of UI and of other social insurance programs, such as workers compensation. Once again, the magnitude of this coefficient is fairly small, with a 10% replacement rate increase raising total annual transfers by less than 2 weeks of incremental UI benefits. This estimate is also of the same magnitude as the estimate for spousal earnings, suggesting that, on net, the reactions of these two forms of insurance are cancelling.

The next row examines the change in food consumption at home, where food stamps have been excluded.[21] Compared to the second row of Table 3, there is a much larger consumption smoothing role for UI when consumption paid for by food stamps has been excluded. This suggests that, as UI becomes more generous, unemployed workers make less use of food stamps in order to smooth consumption. The effect in this case is quite large; smoothing of food consumption at home is roughly 50% larger when food stamps are excluded. But this brings us no closer to explaining the difference between the PSID coefficient in Table 2 and the CEX coefficient in Table 5, since both include food stamps.

Finally, in the bottom two rows I examine the effect of UI generosity on savings behavior. Wealth data are notoriously noisy, and very large outliers can greatly skew the results. I therefore use robust regression techniques which first exclude influential outlying observations, then iterate towards a solution by downweighting those observations with larger residuals (Hamilton, 1991). In this case, there is a very significant interaction between UI and this other form of insurance: for every 10% rise in the replacement rate, gross savings falls by 0.61% of income, and net savings falls by 0.83% of income. Once again, however, the magnitude of the crowding out is quite small. 0.61% of income for 1984 and 1989 is just slightly more than $17, which would be less than one week of the increment to benefits for the person becoming unemployed.

To summarize, then, we have found little evidence that UI is crowding out significant quantities of private insurance. There appears to be some crowdout of spousal earnings and of savings, but both effects are very small. Relative to the increased UI from a 10% rise in the replacement rate, the decline in spousal earnings and the reduction in savings added together amounts

[21]Note that food stamps were not included in the measure of total transfers used in the fourth row of Table 7.

to less than 2 weeks of incremental UI benefits. Furthermore, total transfer income appears to rise as UI becomes more generous, perhaps due to correlated generosity of other social insurance programs, so that the net effect on all non-UI income is very small. There is a strong interaction with food stamps, which suggests that UI does have some crowding out effect in the case of this public assistance program. But food stamps were included in the PSID estimates presented earlier, suggesting that this crowdout cannot explain our large earlier findings. These results are therefore supportive of the consumption smoothing results from the PSID, relative to the CEX, since they imply that variations in UI would be largely reflected in variations in consumption for the unemployed.

Part VI: Conclusions

Traditional analysis of the UI program has ignored the benefits side of the equation in focusing on the effects of UI on unemployment duration and layoff propensities. This paper begins to remedy that deficiency by measuring the consumption smoothing gains from increased UI generosity. The results from both the PSID and CEX suggest that there UI has a significant effect on the consumption of the unemployed, rejecting the notion that there are full private insurance markets for smoothing consumption over this adverse event. The estimated magnitude of the coefficient varies substantially across the datasets, however, with the CEX implying a much smaller consumption smoothing role. I have attempted to reconcile these results by looking at the effect of UI on other forms of insurance, and I found little interaction. This supports the contention from the PSID that the consumption smoothing role is a large one.

What do the findings imply for benefits adequacy? The PSID results, as well as the findings from Part V, suggest that measures of adequacy which simply rely on the replacement rate are not

very badly biased, since there appears to be little crowding out of other forms of consumption insurance for unemployment spells. The CEX results, on the other hand, suggest that there is much more consumption insurance available to the unemployed person, so that simply using the replacement rate to measure adequacy could be quite misleading. Furthermore, according to the CEX results, the consumption smoothing effects of UI are much larger for non-necessities than for necessities. A normative notion of "adequacy" presumably applies more strongly to consumption of necessities, but the CEX implies that such consumption would barely fall even in the absence of UI. On the other hand, both food and housing consumption are affected dramatically by the UI in the PSID.

A crucial issue for future research is therefore to understand the source of difference between the CEX and PSID results. If, in fact, the CEX results are correct and consumption of necessities would only fall slightly during unemployment spells in the absence of UI, benefits may be adequate at quite a low level.

More generally, however, the discussion of adequacy raises the important question: adequate relative to what standard? As emphasized by Baily (1978) and Gruber (1994), optimal UI benefits can only be determined through a comparison of the benefits and costs of the program. Simple calculations using the PSID data in my earlier work suggest that the benefits are still relatively small compared to the costs. But the models in these papers ignore a variety of benefits of UI. These benefits must be incorporated into a richer model which can then provide a general framework for comparing the costs and benefits of this program.

Table 1: Means of the PSID Data All Dollar Values are in 1984 Dollars			
	Full Sample	Remain Employed	Become Unemployed
Food Consumption$_{t-1}$	3992 [2036]	4009 [2040]	3507 [1856]
Rent & Mortgage$_{t-1}$	2831 [2526]	2849 [2543]	2269 [1829]
Age	37.8 [11.8]	38.0 [11.8]	33.9 [10.9]
Female (%)	18.9	18.8	25.5
Married (%)	70.9	71.4	54.6
White (%)	64.4	65.0	48.3
Black (%)	31.9	31.4	47.2
Years of Education	12.2 [3.17]	12.2 [3.18]	11.3 [2.82]
Number of Kids	1.26 [1.37]	1.26 [1.37]	1.23 [1.38]
ΔLog Family Needs	-0.0046 [0.121]	-0.0046 [0.119]	-0.0048 [0.151]
After-tax Previous Real Weekly Wage	286.4 [178.2]	288.9 [178.8]	218.5 [141.8]
Δ in Employment (%)	3.39	0	100
After-Tax Calculated Replacement Rate	0.522 [0.196]	0.520 [0.196]	0.581 [0.166]
Δ Log Food$_{t-1,t}$	0.0054 [0.370]	0.0083 [0.366]	-0.076 [0.456]
Δ Log Rent & Mortgage$_{t-1,t}$	0.017 [0.413]	0.019 [0.411]	-0.046 [0.469]
Number of Observations	48514	46870	1644

Notes: Based on author's calculations using PSID. See text for variable descriptions.

Table 2: PSID Regression Results Dependent Variable is Change in Log Real Consumption			
Consumption Measure	(1) Food	(2) Rent & Mort	(3) Sell? (Probit)
After-Tax Replacement Rate	0.271 (0.097)	0.314 (0.113)	-0.400 (0.429) [-0.019]
Implied Consumption Fall at 0 RR	-0.233	-0.217	0.050
After-Tax Real Wage ($*10^3$)	-0.217 (0.360)	0.478 (0.403)	0.576 (1.478)
Age	-0.002 (0.001)	-0.0002 (0.001)	-0.011 (0.006)
Female	0.047 (0.035)	0.071 (0.041)	-0.360 (0.181)
Married	0.012 (0.033)	0.102 (0.038)	-0.192 (0.156)
White	0.101 (0.055)	-0.003 (0.059)	0.468 (0.324)
Black	0.062 (0.055)	0.024 (0.059)	0.231 (0.327)
Years of Education	0.004 (0.004)	0.002 (0.005)	0.020 (0.023)
Change in Log Food Needs	0.210 (0.077)	0.271 (0.094)	-0.787 (0.352)
Number of Kids	0.019 (0.009)	-0.002 (0.010)	0.107 (0.041)
Number of Obs	1644	942	2193

Notes: Standard errors in parentheses. Sample is those becoming unemployed from period t-1 to period t. All regressions include 16 year dummies. Dependent variable is change in log food expenditures in column (1); change in log rent + mortgage expenditures in column (2); and probability of selling your house in column (3). All regressions exclude outliers.

Table 3: Outliers and Other Elements of Consumption in the PSID		
	(1) Without Outliers	(2) With Outliers
Food Consumption	0.271 (0.097) [-0.233]	0.424 (0.118) [-0.344]
Food at Home Including Food Stamps	0.233 (0.099) [-0.183]	0.256 (0.120) [-0.197]
Food Away from Home	0.388 (0.239) [-0.401]	0.257 (0.273) [-0.342]
Rent & Mortgage	0.314 (0.113) [-0.217]	0.248 (0.137) [-0.192]
Rent	0.158 (0.113) [-0.135]	0.195 (0.141) [-0.176]
Mortgage	0.210 (0.136) [-0.132]	0.129 (0.206) [-0.059]

Notes: Standard errors in parentheses; implied fall in consumption at a zero replacement rate in square brackets. Coefficients are those on the after-tax replacement rate in regressions such as those in Table 2. Regressions without outliers trim the outlying 2% of observations for each consumption measure, as in Table 2.

Table 4: Means of the CEX Data
All Dollar Figures are in 1984 Dollars

	Full Sample	Remain Employed	Become Unemployed
Total Consumption$_{t-1}$	22490 [16825]	23001 [17097]	19235 [14565]
Necessities$_{t-1}$ (Food, Rent/Mort, Utilities)	9100 [4733]	9257 [4769]	8099 [4371]
Non-Necessities$_{t-1}$ (Remainder of Total)	13390 [14395]	13744 [14679]	11135 [12200]
Age	40.8 [11.0]	40.7 [10.8]	41.4 [10.9]
Female (%)	26.5	25.1	35.6
Married (%)	66.2	66.9	61.6
White (%)	86.4	86.7	84.7
Black (%)	9.9	9.5	12.1
Years of Education	12.0 [4.99]	12.0 [5.00]	11.6 [4.91]
Number of Kids	0.97 [1.20]	0.97 [1.19]	0.93 [1.21]
Δ Family Size			
Previous After-Tax Real Weekly Wage	362.2 [315.9]	370.7 [313.0]	307.8 [327.8]
Δ in Employment (%)	13.6	0	100
After-Tax Calculated Replacement Rate	0.449 [0.191]	0.439 [0.189]	0.507 [0.195]
Δ Log Total$_{t-1,t}$	-0.0051 [0.457]	-0.0027 [0.457]	-0.020 [0.458]
Δ Log Necessities$_{t-1,t}$	0.0008 [0.292]	0.0031 [0.287]	-0.014 [0.322]
Δ Log Non-Necessities$_{t-1,t}$	-0.0078 [0.720]	-0.0022 [0.719]	-0.044 [0.728]
Number of Observations	14469	12507	1962

Notes: Based on author's calculations using CEX. See text for variable descriptions.

Table 5: CEX Regression Results
Dependent Variable is Change in Log Real Consumption

Consumption Measure	(1) Total	(2) Necessities	(3) Non-Necessities
After-Tax Replacement Rate	0.131 (0.071)	0.047 (0.049)	0.237 (0.111)
Implied Consumption Fall at 0 RR	-0.088	-0.038	-0.164
After-Tax Real Wage ($*10^3$)	-0.023 (0.040)	-0.004 (0.028)	-0.025 (0.064)
Age	0.0002 (0.001)	-0.002 (0.001)	0.002 (0.001)
Female	0.001 (0.026)	-0.011 (0.018)	0.018 (0.041)
Married	0.012 (0.026)	0.009 (0.020)	0.050 (0.041)
White	-0.105 (0.060)	0.014 (0.042)	-0.231 (0.095)
Black	-0.148 (0.066)	0.019 (0.046)	-0.349 (0.106)
Years of Education	0.004 (0.003)	-0.002 (0.002)	0.009 (0.005)
Number of Kids	-0.003 (0.009)	-0.008 (0.007)	0.009 (0.015)
Δ Family Size	0.054 (0.018)	0.049 (0.013)	0.087 (0.029)
Number of Obs	1914	1919	1913

Notes: Standard errors in parentheses. Sample is those becoming unemployed from period t-1 to period t. All regressions include 16 year dummies. Dependent variable is change in log total expenditures in column (1); change in log necessities (food + rent/mortgage + utilities) in column (2); and log non-necessities (total - necessities) in column (3). All regressions exclude outliers.

Table 6: Outliers and Other Elements of Consumption in the CEX		
	Without Outliers	With Outliers
Total	0.131 (0.071) [-0.088]	0.161 (0.081) [-0.108]
Necessities	0.047 (0.049) [-0.038]	0.093 (0.056) [-0.067]
Non-Necessities	0.237 (0.111) [-0.164]	0.230 (0.126) [-0.158]
Food	0.045 (0.079) [-0.076]	0.093 (0.087) [-0.118]
Food At Home	0.020 (0.082) [-0.040]	0.022 (0.093) [-0.052]
Food Away from Home	0.249 (0.158) [-0.198]	0.268 (0.173) [-0.232]
Rent & Mortgage	0.039 (0.085) [-0.033]	0.177 (0.116) [-0.104]
Utilities	0.038 (0.066) [0.017]	-0.001 (0.101) [0.054]
Clothing & Clothing Services	-0.220 (0.180) [0.035]	-0.181 (0.202) [0.003]
Car Service and Parts	0.119 (0.120) [-0.120]	0.184 (0.129) [-0.162]
Housing Durables & Services	0.363 (0.283) [-0.372]	0.253 (0.296) [-0.341]
Entertainment	0.310 (0.175) [0.058]	0.378 (0.197) [0.029]
Alcohol & Tobacco	0.049 (0.131) [-0.096]	0.041 (0.149) [-0.083]

Notes: Standard errors in parentheses; implied fall in consumption at a zero replacement rate in square brackets. Coefficients are those on the after-tax replacement rate in regressions such as those in Table 2. Regressions without outliers trim the outlying 2% of observations for each consumption measure, as in Table 2.

Table 7: UI and Other Forms of Insurance		
Dependent Variable	(1) Coefficient on Replacement Rate	(2) Number of Obs
Change in Wife's Earnings	-248.7 (308.3)	1822
Change in Wife's Employment Status	-0.049 (0.119)	560
Change in Transfers from Relatives	72.63 (55.08)	2033
Change in Total Non-UI Transfers	267.5 (187.5)	1974
Change in Food at Home Without Food Stamps	0.384 (0.127)	1516
Gross Wealth/Income	-0.061 (0.012)	6230
Net Wealth/Income	-0.083 (0.021)	6230

Notes: Standard errors in parentheses. Coefficients are those on the after-tax replacement rate in regressions such as those in Table 2, without controls for change in log food needs. Regression for food without food stamps trims outlying 2% of observations. Regressions for wealth over income are run for all persons in 1984 and 1989; other regressions run for those losing jobs only.

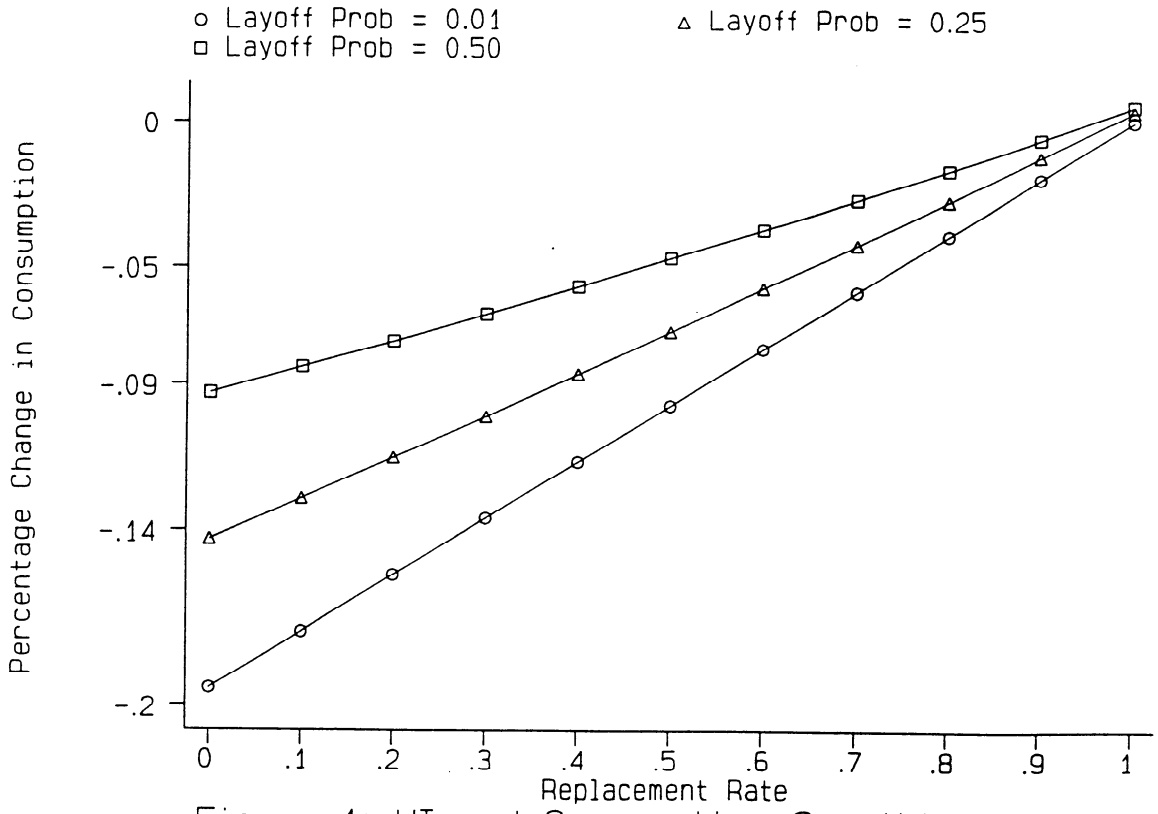

Figure 1: UI and Consumption Smoothing

Table A1: Replacement Rates Across States and Over Time

St	1969	1979	1987	Change, 69-87	Change, 79-87
AL	.686	.563	.357	-.329	-.205
AK		.353	.721		.368
AZ	.510	.468	.341	-.169	-.127
AR	.476	.547	.456	-.019	-.091
CA	.586	.486	.352	-.233	-.134
CO	.644	.682	.486	-.157	-.196
CT	.651	.563	.369	-.283	-.194
DE		.681	.534		-.147
DC	.672	.714	.582	-.090	-.131
FL	.509	.470	.408	-.101	-.062
GA	.555	.540	.397	-.158	-.143
HI		.590	.424		-.166
ID		.315	.361		.046
IL	.573	.560	.390	-.182	-.170
IN	.465	.453	.310	-.156	-.143
IA	.550	.600	.447	-.102	-.153
KS	.528	.580	.494	-.033	-.085
KY	.494	.526	.409	-.085	-.117
LA	.696	.716	.572	-.124	-.144
ME	.478	.553	.434	-.044	-.118
MD	.616	.599	.483	-.133	-.116
MA	.567	.518	.412	-.155	-.105
MI	.619	.480	.442	-.177	-.037
MN	.424	.492	.429	.005	-.063
MS	.580	.534	.451	-.128	-.083
MO	.557	.455	.401	-.156	-.054
MT			.528		
NE	.624	.684	.407	-.217	-.277
NV		.514	.449		-.065

NH		.517	.283		-.233
NJ	.564	.466	.456	-.109	-.010
NM		.599	.342		-.257
NY	.558	.532	.377	-.181	-.155
NC	.599	.616	.486	-.113	-.130
ND	.379	.620	.629	.250	.008
OH	.506	.566	.410	-.096	-.155
OK	.417	.500	.457	.040	-.044
OR	.469	.488	.483	. 014	-.005
PA	.594	.650	.515	-.079	-.135
RI		.610	.411		-.198
SC	.568	.592	.411	-.157	-.180
SD	.488	.493	.347	-.141	-.146
TN	.534	.540	.352	-.182	-.187
TX	.548	.496	.455	-.093	-.041
UT	.493	.582	.415	-.078	-.168
VT		.719			
VA	.545	.557	.392	-.153	-.165
WA	.417	.501	.389	-.029	-.112
WV	.623	.621	.420	-.203	-.201
WI	.575	.612	.426	-.149	-.187
WY		.530	.427		-.103

Note: Each cell reports the average after-tax replacement rate for that state/year, calculated using the PSID data and the simulation program described in the text

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KRA

Corporation

The Work Search Test Under Extended Benefits

Contract No. M-4344-3-00-97-30

Submitted to:

Advisory Council
on Unemployment Compensation

November 22, 1993

1010 Wayne Avenue
Suite 850
Silver Spring, Maryland 20910

A Diversified Small Business Professional and Technical Services Organization

The Work Search Test Under Extended Benefits

Although there has been extensive research on the subject of extended benefits, efforts to uncover existing research on the topic of the work search test have proven fruitless. There appear to be no sources that pertain only to the work search test under extended benefits. Of the sources relating to the broader topic of extended benefits, none were found to contain any reference to the work search test. A brief chronology of legislation regarding extended unemployment benefits and the work search test is included below[1]:

- October 1970--The Employment Security Amendments of 1970 (Public Law 373) establish the Federal-State Extended Unemployment Compensation Program and set the guidelines under which the program operates. The program became operative nationally after January 1, 1972.

- July 1975--The Emergency Compensation and Special Assistance Act (Public Law 45) amends the Extended Benefits Program's regulations. Included in the modifications is a change in the eligibility requirements of unemployed recipients: unemployed workers must be willing to apply for or attend a vocational training course if the State determines that he or she needs such training.

- April 1977--The Emergency Unemployment Compensation Act of 1977 (Public Law 19) further modifies the eligibility requirements of recipients of extended benefits. The new law requires claimants to be actively seeking work and to accept any offers of suitable work to maintain eligibility for extended benefits.

- July 1992--Congress passed the Unemployment Compensation Amendments of 1992 (Public Law 318). The amendments modify the triggers associated with the activation of the Extended Benefits Program and eliminate the federally mandated eligibility work search requirements. Effective October 1, 1993, State laws regarding work search regulate eligibility of recipients.

Following the passage of the Emergency Unemployment Compensation Act of 1977, recipients of extended benefits (EB) had to meet a complex set of Federal job search requirements. The requirements were as follows:

- An individual is not eligible for EB if (a) he or she fails to accept an offer of "suitable work" or to apply for suitable work to which he or she was referred to by a State agency; or (b) he or she is not actively engaged in job search. Those individuals issued a summons to appear for jury duty or hospitalized are exempt from the active job search requirement.

- If a claimant is ineligible due to either of the above circumstances, the individual must be employed for at least 4 weeks and earn at least 4 times his or her weekly benefit before again becoming eligible for EB.

- "Suitable work" is defined as any work within the claimant's capabilities, unless the claimant can provide evidence that the prospects of finding work in his or her customary occupation within a reasonably short time are good; in which case, "suitable work" conforms to State law.

- EB may not be denied to a claimant for failure to apply for or accept a suitable job if (a) the gross pay does not exceed the claimant's weekly benefits plus any supplemental benefits; (b) the position was not offered in writing and was not listed with the State Employment Service; (c) such failure would not make the claimant ineligible for State unemployment benefits; or (d) the job pays wages less than the higher of Federal, State, or local minimum wage laws.

- The claimant is considered to be actively engaged in seeking work if he or she has tangible proof of a systematic and sustained effort to obtain employment.

- The State must refer applicants for EB to any suitable work as outlined above.

- The State laws that regulate the disqualification of claimants for regular benefits because of voluntarily leaving a job, being discharged for misconduct, or refusing suitable work do not apply to EB unless such termination is based on subsequent employment.

- To be eligible for EB, a worker must meet State employment and earnings measures in his or her base year.

As previously noted, the passage of the Unemployment Compensation Amendments of 1992 eliminated the federally mandated work-search requirements and returned the responsibility of establishing work-search requirements to the States. The amendments of 1992 also require

> the Federal Advisory Council on Unemployment Compensation to study and make recommendations to the tax-writing Committees of Congress on whether or not the [federally mandated work search] provisions should be repealed or revised. A report is due prior to February 1, 1994[2].

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The H-2A Program: Trends, Issues, and Options[1]

Philip L. Martin
March 4, 1994

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[1]This paper will be revised and retitled as Immigration, Agriculture, and Unemployment Insurance for an ACUC conference of contributors. 28,503 text words, 5,284 in footnotes.

Executive Summary

U.S. farm employers have imported legal nonimmigrant farm workers with H-2 or H-2A visas since 1942 without paying Federal Unemployment Tax Act (FUTA) taxes on their earnings. Until 1978, most farm workers were excluded from the Unemployment Insurance (UI) system, so the question of paying FUTA taxes on the earnings of nonimmigrant farm workers did not arise. When UI coverage was extended to an estimated 500,000 farm workers[2] in 1978 (NCUC, 1980, p. 22), the earnings of H-2 workers were excluded from FUTA taxes, and this exemption has been extended every two or three years, with the current exemption due to expire on January 1, 1995 (IRC Section 3121(b)(1), SSA~210(a)(1)(B). Beginning in 1980, farm employers employing both H-2A and U.S. workers have been required to include the earnings of H-2 workers in the calculation small farm employers are required to make to determine whether their U.S. workers should be covered under UI.

The H-2A Program

The H-2A program has since June 1, 1987[3] permitted U.S. farm employers who anticipate shortages of labor to import nonimmigrant aliens to perform agricultural labor of a temporary or seasonal nature, i.e., both the workers and the work must be temporary, and temporary is usually construed to mean less than 12 months.[4] The Immigration and Naturalization Service (INS) makes the final decision on the employer's petition for H-2A workers. The INS normally rejects employer petitions unless they are accompanied by a Department of Labor (DOL) certification (1) that U.S. workers who are "able, willing and qualified" are not and will not be available to fill the job vacancy for which the employer is

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[2]Since January 1, 1978, farm employers have been required to extend FUTA coverage to U.S. workers if they hire 10 or more individuals in 20 different weeks during the year, or if they pay $20,000 or more in quarterly wages.

[3]Between 1953 and 1987, nonimmigrant farm workers were admitted under Section 214(c) and 101(a)(15)(H)(2) of the Immigration and Nationality Act of 1952. This program was known as the H-2 program. The H-2A program came into force on June 1, 1987. Immigration & Nationality Act, 8 U.S.C. 1101(a)(15)(H)(ii)(a), 1186

[4]There is one exception: 1100 H-2A sheepherders (one-third of whom are employed in California)—must have their need recertified each year, but they are allowed to remain in the United States continuously as H-2A workers for up to 36 months.

requesting H-2A workers, and (2) that the employment of the H-2A workers will not adversely affect similar U.S. workers.

Farm employers wishing to employ H-2A workers must follow an application process set out in law and regulation. The application process requires U.S. employers to complete a job order seeking U.S. workers that details the jobs, wages, and working conditions for the vacancy(ies) for which H-2A workers are sought. This job order must be filed, at least 60 days before the anticipated need for H-2A farm workers, with (1) the regional DOL office and (2) the local Employment Service (ES) office. DOL/ES then has 40 days to determine whether the job order satisfies its regulations; to search for workers in traditional areas of recruitment, such as in south Texas for midwestern and mountain state farmers requesting H-2A workers; and to issue or deny the employer's request to be certified to import H-2A workers.

About 95 percent of the 3000 farm employer requests annually for certification that H-2A workers are needed are approved, and the farm employer then attaches the DOL certification to the petition to INS. The INS transmits its approval to admit holders of H-2A visas to fill the job order to the Department of State (DOS) consulate in H-2A workers' country of origin, where the visas needed to enter the United States legally are issued to H-2A workers.

The H-2A program was expected to expand from about 20,000 jobs certified and workers admitted annually in the mid-1980s to 200,000 or more after IRCA's employer sanctions took full effect in U.S. agriculture in 1989.[5] Farmers were certified to import H-2A workers to fill 26,600 jobs in 1989, but since then the number of certifications has fallen 35 percent to 17,200 in 1993.[6] Employer requests for H-2A farm workers are expected to continue decreasing, largely

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[5]In a typical late 1980s analysis and prediction, one author asserted that "growers prefer to hire temporary foreign farm workers because they are less expensive, easier to manage, and less likely to sue their employers... the temporary foreign farm worker program is expanding in both breadth and importance. As additional growers participate in the program and seek to employ unprecedented numbers of temporary foreign farm workers, renewed certification battles may be inevitable." (Coleman, 1989, p. 197).

[6]DOL certified labor shortages for 25,700 farm jobs in 1991, but the number fell to 18,700 in 1992 and to 17,246 in 1993, largely because the Florida sugarcane harvest, for which 8000 H-2A workers were admitted in 1991, has largely been mechanized, so that only 2000 H-2A workers were admitted by one company, U.S. Sugar, in 1993-94. Fewer H-2A workers were requested by Connecticut tobacco growers and Idaho farmers seeking irrigators, although North Carolina and Virginia tobacco growers were certified for almost 5000 workers in 1993.

The number of vacant jobs for which H-2A workers are certified to fill is still almost twice the level for H-2B workers. H-2B workers are admitted to fill unskilled nonfarm jobs for which the DOL determines that there are insufficient American workers. Many of the jobs filled by H-2B workers are "near-ag" jobs, such as tree planters, stable hands, and fish processing jobs. (Conversations with John Hancock, January 4, 1994 and February 18, 1994.)

because of the mechanization of the sugarcane harvest in Florida[7] and spread of both legal and unauthorized Mexican immigrant workers throughout the United States. Farmers on the Eastern seaboard who once recruited H-2A workers to ensure that they would have a seasonal workforce now report that (usually Mexican)workers with what appear to be valid work authorization documents show up when they are needed, making it unnecessary to go through the H-2A certification process.

The FUTA Exemption

The FUTA exemption saves employers of H-2A workers about $1 million annually. In addition, employers save about $4 million annually in state UI taxes on the wages of H-2A earnings. It is widely agreed that the FUTA exemption is not the major reason why employers request H-2A workers: the H-2A program is considered by many farmers to be a superior Employment Service (ES) because it permits farm employers to select guaranteed-to-show-up seasonal workers from a huge foreign labor pool. However, the FUTA exemption, and the related exemption of H-2A earnings from FICA (Social Security) payroll taxes, does create a "payroll tax wedge" that may help to explain the persistence of employment of H-2A workers in particular commodities and areas--once growers hire H-2A workers, they rarely revert to employing American workers. The earnings of nonfarm temporary workers such as H-2Bs are subject to FUTA and FICA taxes, even though, like H-2A workers, such workers are not generally eligible for benefits under these programs.

DOL and the state ES system currently spend about $15 million annually to process about 3000 farm employer requests for certification that H-2A workers are needed to fill vacant jobs. DOL charges only for approved certifications, and only H-2A employers pay for DOL certification letters; it appears that DOL collects less than $500,000 annually in certification fees from H-2A employers. In addition, DOL incurs costs to study the H-2A program, and to deal with the litigation that often swirls around the program. There have been proposals to substitute a user fee--10 to 20 percent of the earnings of H-2A workers--to reflect employer

[7]The number of workers involved in what has traditionally been the activity that involved the most H-2A workers has fallen from 11,000 in 1989-90 to 2000 in 1993-94 (these workers arrive in October-November and remain until March-April).

FUTA and FICA savings, to cover some of DOL's costs to administer the H-2A program, and to substitute for some of the current welter of H-2A regulations.

Previous Recommendations

The NCUC in 1980 recommended 7-5 that the "present FUTA exclusion from the coverage of services performed by certain types of alien contract labor be terminated" (1980, p. 27). The majority cited the payroll tax wedge that the exemption gives to employers of H-2 workers as a reason to end the exclusion. The minority countered that H-2 farm workers are not eligible for UI benefits, and that such workers' earnings are not subject to FICA taxes, as reasons to maintain the exemption (1980, p. 189-190).

The Select Commission on Immigration and Refugee Policy recommended, by a vote of 14-2, three changes in the H-2 program, including:

> "REMOVE THE CURRENT ECONOMIC DISINCENTIVES TO HIRE U.S. WORKERS BY REQUIRING, FOR EXAMPLE, EMPLOYERS TO PAY FICA AND UNEMPLOYMENT INSURANCE FOR H-2 WORKERS; AND MAINTAIN THE LABOR CERTIFICATION BY THE U.S. DEPARTMENT OF LABOR." (SCIRP, 1981, p. 226, emphasis in original)[8]

The Commission on Agricultural Workers (CAW) in 1992 recommended that the same program be available to farm and nonfarm employers "for the importation of temporary nonimmigrant workers" (CAW, 1992, p. xxviii), which would imply an end to the FUTA and FICA exemption on the earnings of H-2A workers.

The NCUC in 1980 recommended unanimously that the small farm exclusion from UI coverage be dropped (1980, p. 27), as did the CAW in 1992: "agricultural employees should be provided with federal/state UI coverage that provides them with protection against unemployment that is comparable to that of other workers in the United States."[9] The NCUC worried about the relationship between farm employers and labor market middlemen such as

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[8]SCIRP also recommended that the H-2 application process be streamlined so that farm employers would not have to apply 80 days before the date they expected to need workers (IRCA lowered to 60 days the minimum time before the need date that the employer must file a request for labor certification with a local ES office) and SCIRP recommended that "GOVERNMENT, EMPLOYERS AND UNIONS SHOULD COOPERATE TO END THE DEPENDENCE OF ANY INDUSTRY ON A CONSTANT SUPPLY OF H-2 WORKERS", although SCIRP note that adopting these recommendation should not preclude A SLIGHT EXPANSION OF THE PROGRAM (emphasis in original).

[9]CAW recommendations were adopted by consensus. Three of 11 commissioners signed a supplemental statement that argues that the CAW should not have made recommendations on UI (1992, p. 154).

farm labor contractors (FLCs). By a vote of 9-3, the NCUC recommended that the farm operator be considered the employer unless there is s signed agreement between the operator and a FLC who brings workers to a farm that the FLC is the employer (1980, p. 27). The CAW, dominated by farm employer representatives, was more concerned about the administration of UI benefits to migrant and seasonal farm workers. CAW cautioned that UI coverage of farm workers would require "close monitoring ...to ensure program integrity because many farm workers have multiple employers" (CAW, 1992, p. xxviii).

Eight states, including the three major farm labor states that probably employ more than half of all farm workers--CA, FL, and TX--have already extended mandatory UI coverage to most farm workers on smaller farms.[10] Extending UI coverage to farm workers raises several issues, including the fact that, with a 10 to 30 percent--and rising--share of unauthorized workers in the farm workforce, an increasing percentage of farm workers on whom FUTA is paid may not be eligible for UI benefits. There have been allegations that the labor contractors who play an increasingly important role in matching workers and jobs may in some instances encourage or require workers to draw UI benefits under one Social Security Number and then work for substandard and non-reported cash wages under another.

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[10]Survey data suggest that some farm workers in states with comprehensive UI coverage may not be eligible for UI benefits because their employers do not pay required UI taxes. In the course of constructing employer lists to sample workers for the NAWS, Richard Mines reports that in many cases farm employers were not on the UI lists maintained by state UI offices. Since enforcement tends to focus on employers who have UI reporting numbers, but who do not pay UI taxes on all of the wages they pay, some farm employers who do not have UI-reporting numbers escape detection.

Mines believes that, to improve farm worker access to the UI system, better enforcement of existing laws requiring farm employers to pay UI taxes is as important as extending coverage to more farm workers.

Part 1. The H-2A Program and Unemployment Insurance in Agriculture

Introduction

This report reviews the impact of the exemption from Federal FUTA taxes of the earnings of H-2A farm workers. The H-2A program permits U.S. farm employers who anticipate a shortage of farm workers to bring into the United States temporary nonimmigrant aliens to perform agricultural labor of a temporary or seasonal nature, i.e., both the workers and the work must be temporary, and temporary is usually construed to mean less than 12 months.

The United States has imported temporary foreign farm workers under immigration exceptions every year since 1942. Most were admitted under a series of so-called Bracero agreements with Mexico between 1942 and 1964; fewer than 700,000, or about 10 percent of the legal alien farm worker admissions over the past half century, were made under the H-2A provisions of the Immigration and Nationality Act (INA) of 1952[11], as amended by the Immigration Reform and Control Act (IRCA) of 1986. However, since the Replenishment Agricultural Worker program expired on October 1, 1993 without ever admitting alien farm workers, the H-2A program[12] is the only program through which U.S. farmers can legally secure the services of temporary foreign farm workers (Figure 1).

The FUTA Exemption

Farmers appear to have never paid FUTA taxes on the earnings of legally-admitted temporary farm workers. Until 1972, virtually all farm workers were excluded from the Unemployment Insurance system. Beginning January 1, 1978, workers employed by large farm employers were brought into the UI system and, at that time, the first of a series of

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[11]Public Law 82-144. Section 214(c) and 101(a)(15)(H)(2) created the H-2 program, which became the H-2A program after IRCA amendments in 1986 (Public Law 99-603, 100 Stat. 3359). For consistency, the program will be referred to as the H-2A program throughout this report, although in some cases, the pre-June 1, 1987 program will be correctly referred to as the H-2 program.

[12]Canada has MOU agreements with the governments of Mexico and Jamaica under which temporary foreign farm workers are permitted to work legally in Canada. The U.S. has no similar MOUs with Mexico and Jamaica–once DOL certifies a farm employer's need for H-2A workers, that farm employer is free to recruit H-2A workers in any country and under whatever criteria he chooses.

exemptions from FUTA taxes of the earnings of H-2A workers was enacted.[13] The current exemption from FUTA taxes of the earnings of H-2A workers is due to expire on January 1, 1995.

Three Background Considerations

Three background considerations seem important in considering the impact of the H-2A FUTA exemption:

1. The direct value of the FUTA exemption to the employers of H-2A workers is less than $1 million annually. The government does not collect data on the earnings of H-2A workers. If 20,000 H-2A workers earn an average $6000 each, their total earnings would be $120 million, and a 0.8 percent FUTA tax on this wage bill would be $960,000.[14] In addition, the major H-2A using states also exempt from state UI taxes the earnings of H-2A workers, so that in Florida, Virginia, and North Carolina--the 3 states that accounted for over half of all H-2A jobs certified in 1991--H-2A employers were also exempt from the 5 to 6 percent UI taxes that employers of seasonal workers typically pay.[15] If 2/3 of H-2A earnings are paid in states that exempt H-2A earnings from state UI taxes, then the total value of the FUTA exemption is about $5 million.[16]

2. Only the earnings of H-2A farm workers are exempt from FUTA. Under the H-2B program, which permits employers anticipating shortages of unskilled nonfarm workers to import temporary alien workers, employers also apply to DOL for certification that they are offering prevailing wages and conditions, and that American workers are not available. DOL generally accepts without inspection employer assertions that the wages and working

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[13]Since 1980, the earnings of H-2A workers are included in the calculation to determine whether the farm is large enough to be required to provide UI coverage to workers (Public Law 96-84).

[14]FUTA taxes are 0.8 percent of the first $7000 of each employee's earnings. Some of earnings of the H-2A sheepherders, who earn $700 to $1000 monthly for 11 months, exceed $7000 annually and would not be subject to FUTA.

[15]In these FUTA-exempt states, employers with both U.S. and H-2A workers must include the wages of the H-2A workers in the calculation necessary to determine whether their U.S. workers must be covered by UI. If the H-2A employment pushes a U.S. employer over the 10-20 threshold for coverage, then the employer must keep separate books of the earnings of H-2A and U.S. workers, and pay FUTA on the U.S. workers earnings. The fact that H-2A workers cannot draw UI benefits does not affect the employer's experience rating because the H-2A earnings do not enter into the taxable wage base.

[16]The $5 million includes $1 million from FUTA and 5 percent of $80 million in H-2A earnings in the exempt states, or $4 million.

conditions in the employer's application for H-2B workers are prevailing ones for the job in question; DOL does not incur costs to conduct wage surveys or to do housing inspections for employers requesting unskilled nonfarm workers, as it does for the H-2A program.

After DOL certifies the need for H-2B workers, and the INS approves the employer's request, a notice goes to the Internal Revenue Service (IRS), and a Social Security Number (SSN) is issued to the H-2B worker so that the employer can pay FUTA and state UI taxes as well as FICA taxes on the earnings of such workers. Employers of most other categories of temporary workers are also required to pay FUTA and FICA taxes on their earnings.[17] Participation in labor market programs funded by payroll taxes is mandatory in most European guestworker programs. In other words, the fact that the alien workers in most cases will not benefit from their own (Europe) and/or their employer's (Europe and U.S.) UI contributions has not prevented the United States or European nations from requiring such payments.

3. The major payroll cost savings for employers of H-2A workers is the exemption of H-2A worker earnings from the Federal Insurance Contribution Act (FICA or Social Security)[18], not FUTA. FICA saves the employer (and worker) each 7.65 percent of earnings,[19] and a combined 15.3 percent of an estimated $120 million in annual H-2A earnings represents a savings of over $18 million. One observer pointed out that, if the FUTA exemption for the earnings of H-2A workers is eliminated, it may be hard to maintain the FICA exemption.[20]

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[17]According to the INA, "the wages of certain nonimmigrants specifically are exempt from unemployment taxes, including students and exchange visitors (F, J, or M visa holders) who are performing work to carry out the purposes of their nonimmigrant classifications." (U.S. House of Representatives, 1992, p. 496). These nonimmigrants are not considered workers while in the United States.

[18]All wages are generally subject to FICA. Exceptions include cash wages of less than $150 paid to one farm worker if the employer paid less than $2500 to all farm workers. Even if the employer paid more than $2500 to all farm workers, wages of less than $150 to any one worker remain exempt if the worker in question is paid a piecerate wage to hand-harvest crops, commutes daily from a permanent residence to the farm, and was employed in agriculture less than 13 weeks in the previous calendar year (Davenport, 1993, p. 1117-8)

[19]H-2A workers from the BWI have 1 percent of their U.S. earnings contributed on their behalf to a pension account in the BWI.

[20]According to the INA "Even though OASDI extends to all individuals who engaged in covered employment, the ability of certain aliens to receive benefits is limited...Section 205(cN2NB)(i) of the Act (42 U.S.C. 405(c)(2XB)(i)) limits the issuance of social security account numbers to citizens and those aliens whose status does not prohibit them from engaging in employment." (U.S. House of Representatives, 1992, p. 491).

Previous Recommendations

The NCUC in 1980 recommended 7-5 that the "present FUTA exclusion from the coverage of services performed by certain types of alien contract labor be terminated" (1980, p. 27). The majority cited the payroll tax wedge that the exemption gives to employers of H-2 workers as a reason to end the exclusion, while the minority cited the fact that H-2 farm workers cannot draw UI benefits and that such workers' earnings are not subject to FICA taxes as the reason to maintain the exemption (1980, p. 189-190). The Select Commission on Immigration and Refugee Policy recommended, by a vote of 14-2, three changes in the H-2 program, including:

"REMOVE THE CURRENT ECONOMIC DISINCENTIVES TO HIRE U.S. WORKERS BY REQUIRING, FOR EXAMPLE, EMPLOYERS TO PAY FICA AND UNEMPLOYMENT INSURANCE FOR H-2 WORKERS; AND MAINTAIN THE LABOR CERTIFICATION BY THE U.S. DEPARTMENT OF LABOR." (SCIRP, 1981, p. 226, emphasis in original)[21]

The Commission on Agricultural Workers (CAW) in 1992 recommended that the same program be available to farm and nonfarm employers "for the importation of temporary nonimmigrant workers" (CAW, 1992, p. xxviii), which would imply an end to the FUTA and FICA exemption.

H-2A Program Issues

The FUTA and FICA exemptions create what the Select Commission on Immigration and Refugee Policy (SCIRP) termed a "payroll tax wedge"[22] that may encourage farm employers to prefer H-2 workers; this wedge was one of 4 rationales offered by farm worker advocates in 1981 to eliminate or at least not expand the then H-2 program. Farm employers, who were not heavily involved in SCIRP deliberations in 1979-80, responded that the labor certification process imposes recruitment, housing, and transportation costs on employers that are greater than these payroll tax savings.[23]

The payroll tax wedge is real, but it is important to remember that the major reason why farm employers prefer H-2A workers is that they can select guaranteed-to-show-up workers from a huge foreign labor pool, rather than what have been called the "dregs" of the American workforce.[24] Employers seeking H-2A workers prefer to select the best young Jamaican or

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[21]SCIRP also recommended that the H-2 application process be streamlined so that farm employers would not have to apply 80 days before the date they expected to need workers (IRCA lowered to 60 days the minimum time before the need date that the employer must file a request for labor certification with a local ES office) and SCIRP recommended that "GOVERNMENT, EMPLOYERS AND UNIONS SHOULD COOPERATE TO END THE DEPENDENCE OF ANY INDUSTRY ON A CONSTANT SUPPLY OF H-2 WORKERS", although SCIRP note that adopting these recommendation should not preclude A SLIGHT EXPANSION OF THE PROGRAM (emphasis in original).

[22]Briefing paper on the H-2 program prepared for the May 5, 1980 Albany regional hearing; reprinted in Appendix F to the SCIRP Staff Report, 1981, p. 13.

[23]According to James Holt, employers participating in the H-2 program will find "that the cost per worker under the program is higher than if only legal U.S. workers are employed" because of free housing, transportation costs, and work guarantees. "These increased costs...are not offset by the alleged savings that accrue because employers are not required to pay SS and UI taxes on the earnings of H-2 workers." (Holt, 1982, p. 2.2.4.)

[24]The President of the California farm Bureau expressed this view in this way: "there is an insufficient amount of capable domestic labor to meet the peak harvest needs of California's agriculture. Because of this, farmers have been compelled to make use of such domestic labor as is available . . . This includes the affording of employment to persons who . . . are unemployable elsewhere . . . because farmers do offer job opportunity to such

Mexican workers to cut sugarcane in Florida or harvest tobacco in North Carolina, rather than to accept referrals of unemployed workers from the Employment Service (ES) offices in South Texas or elsewhere. The H-2A program is, in effect, a better "ES" for recruiting seasonal farm workers--most employers whose petitions trigger, inter alia, an interstate ES recruitment process, do not want the ES system to find U.S. workers for them.[25]

The ES is caught in the middle between employers who want H-2A farm workers and farm worker advocates who are convinced U.S. workers are available. If the ES succeeds in recruiting U.S. workers, the employer may be upset, and find ways to declare the U.S. workers unqualified so that he can get the H-2A workers desired. If, on the other hand, neither the employer nor ES can recruit U.S. workers, then farm worker advocates my sue, alleging that the employer and ES did not look hard enough for workers, or refused to hire or retain qualified U.S. workers.

Truly testing the labor market to determine whether U.S. farm workers will be available to fill jobs that will be available in one or two months "cannot be made to work when only the government wants it to."[26] A federal court explained the difficult DOL role in the certification process as follows: "any statutory scheme [that permits H-2 worker admissions and seeks to protect U.S. workers]must inevitably strike a balance between the two goals. Clearly, citizen workers would best be protected and assured high wages if no aliens were allowed to enter. Conversely, elimination of all restrictions upon entry would most effectively provide employers with an ample labor force."[27]

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of these people . . . much of what is essentially a problem of society as a whole has been placed on the farmers' doorstep."

"To burden California agriculture with problems that are rightfully the responsibility of everyone in the State will destroy the family farm system . . . economy of the state." (California Senate, 1961, p. 9)

[25]David North prepared in the late 1970s a much reproduced table comparing the circumstances under which H-2 and non-H-2 workers can be hired. He grouped the differences between hiring the two kinds of workers in to 8 groups, ranging from the payroll tax wedge to paperwork differences.

[26]Testimony of James Bailey, ETA, DOL, before the CAW July 20, 1990, reprinted in CAW Report, Appendix II, p. 15.

[27]Rogers v. Larson, 563 F.2d. 617, 626 (3rd Circuit 1977). Quoted in the Testimony of Malcolm Lovell before the U.S. Senate. Committee on the Judiciary, Subcommittee on Immigration, Refugees and International Law, November 30, 1981, 9.

DOL H-2A Administrative Costs

The DOL spends a considerable amount of money on the contentious H-2A certification process. DOL distributes an H-2A labor certification grant to states of about $12 million annually, and spends another $2 to $3 million annually at the regional and national levels on farm worker certification activities.[28] DOL receives about 3000 employer applications annually requesting that H-2A workers be certified, and approves 95 percent of them, at an average total cost of about $5000 per employer application ($15 million divided by 3000). DOL charges a fee for approved labor shortage certifications: $100 for each certification, plus $10 per H-2A worker, to a maximum $1000 per employer certification, for a total of perhaps $400,000.[29]

Every aspect of the H-2A labor certification process has been litigated, often numerous times, from the employer's job description (is it written in a way to discourage U.S. workers from applying?), to the free housing U.S. and H-2A workers must be offered (if the U.S. workers typically come in families, must the employer offer them free family housing?), to the hourly and piecerate wages that must be offered to U.S. and H-2A workers, to the requirement that employers of H-2A workers must continue to accept referrals of U.S. workers--even if their arrival requires that an H-2A worker be discharged and sent home early--until 50 percent of the work has been completed. It is very difficult for the ES in this litigious environment to play simultaneous regulatory and service roles: the ES must inspect housing and check on employer recruitment activities before granting certification that H-2A workers are needed, while simultaneously trying to be a no-fee labor brokerage service that refers unemployed workers to these same employers who have already decided that they need foreign workers.

User Fees and the H-2A Program

During the debates over reforming the H-2 program a decade ago, I proposed that an economic approach to substituted for the proliferation of rules and regulations governing the

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[28]DOL estimated the federal cost per certification at $400 per employer application in 1987, and apparently proposed charging employers $400 per employer certification in 1987 regulations implementing the H-2A program. Employers protested, and the $100 and $10 per H-2A formula was adopted. Conversation with John Hancock, December 1993.

[29]The 3000 employer applications for certifications @$100 generate $300,000, and if the $10 per worker applied to 10,000 workers, per worker fees would add $100,000.

program (Martin, 1980).[30] I noted in 1983 that if employers were charged their 7 percent share of FICA, and a conservative 3 percent more to reflect FUTA and state UI tax savings, then a 10 percent user fee on the earnings paid to H-2 workers could be generated to help to cover the cost of administering the program and to help farmers and farm workers develop programs that would end their dependence on H-2 workers.[31] Farm employers argued that the then H-2 program was too "inflexible" for "perishable" commodities, so I proposed that, after deducting administrative costs, the remainder of the user fee would be held in commodity-specific trust funds, as occurs when producers of commodities from avocados to pork assess themselves a small fee for each unit of production for research and promotion activities–all users of H-2 workers would have been required to pay assessments equal to 10 percent of the wages they paid to H-2 workers.

The "H-2 trusts" I proposed would have been administered by government, employer, and farm worker representatives. The hope was that the joint responsibility to allocate funds would help to reduce the contention that often surrounds farm employer and farm worker advocate debates over the H-2 program. For example, sugarcane trust funds might be divided between mechanization research and programs that seek to recruit and upgrade the skills of farm workers. The amount of money in the trust would of course depend on the earnings of H-2 workers, and if the parties were so polarized that they could not agree on how to expend trust funds, the moneys would accumulate.

Economists generally liked the idea of substituting an economic steering mechanism for the admission of H-2 workers. However, the idea was doomed by opposition from growers and worker advocates. Growers feared that a 10 percent user fee on the earnings of H-2 workers would simply add to their costs; farm worker advocates feared that the H-2 admission

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[30]This paper made 5 recommendations, including (1) that farm workers be recognized as an integral part of U.S. agriculture, and that farmers plan for continuing relationships with their workers, (2) that illegal aliens were not distributed equally throughout agriculture, providing a selective subsidy that could be curtailed with equal and effective enforcement; (3) that the payroll tax wedge favoring the employment of H-2 workers could be reduced with a 10 percent tax on H-2 workers' earnings; (4) that farmers using H-2 workers be required to develop impact statements detailing how they were going to end their dependence on foreign workers; and (5) that USDA work to promote the spread of progressive personnel practices in agriculture, since they seem to diffuse much slower than biological and mechanical innovations.

[31]Based on average earnings then of $4000, this user fee would have been about $400 per H-2A worker per year.

regulations that they wanted to stiffen would instead be eased in exchange for the fee. Finally, Congressional immigration reformers pointed out that implementing user fees would complicate their efforts to enact immigration reforms by involving tax committees in the process.

The trust fund idea was also (wrongly) attacked as a tax on poor H-2 workers. The supply of temporary foreign farm workers is perfectly elastic at the highest of the three wages that an employer must offer--the minimum wage, the Adverse Effect Wage Rate (AEWR)[32], or the prevailing wage rate. In such a labor supply situation, any fees or taxes are paid by employers.

The H-2A Program in the 1990s

The number of farm jobs for whom growers seek H-2A workers is declining, largely because the 1987-88 legalization of over 1 million illegal alien farm workers expedited the spread of Hispanic farm workers throughout the United States, and because unauthorized workers continue to arrive and purchase the documents needed to be employed "legally" (CAW, 1992). Instead of going through the often litigious process of importing H-2A farm workers, farm employers from New England to Florida, the areas in which H-2A workers have been imported, are increasingly hiring the immigrant Mexican workers who appear. No one expects this substitution of immigrant Mexican for British West Indies (BWI) H-2A workers to slow in the 1990s.[33]

However, the H-2A program is not likely to disappear. It is the only program through which temporary foreign farm workers can be admitted legally, and if there is a new round of immigration controls that succeeds in curtailing illegal immigration, the H-2A program could increase in size. The Immigration Act of 1990 (IMMACT) revised the procedure for admitting temporary nonfarm workers; in 1992, H-2A farm workers were only 10 percent of the 163,000 temporary alien workers admitted to the United States.

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[32]The AEWR is a DOL-determined hourly wage that must be offered to U.S. and H-2A workers to prevent the employment of the H-2A workers from "adversely affecting" U.S. workers.

[33]About 3/4 of the H-2A jobs certified in 1991 were filled by workers from the BWI. The H-2A program did expand in NC and VA, as tobacco farmers there increased their hiring of H-2A workers from Mexico. In 1991, 1,500 tobacco-vegetable H-2A workers were certified in NC, versus 400 in 1990, and in VA 2,600 were certified in 1991, versus 2,400 in 1990.

Farmworkers and Unemployment Insurance

The Small Farm Exemption

Farm workers were excluded from the Unemployment Insurance system and most other labor laws enacted in the mid-1930s, and most of them remained excluded from UI until 1978, when the federal government required larger farm employers to be brought into the UI system. California, which includes 25 to 35 percent of the nation's farm workers, adopted practically universal UI coverage of farm workers in 1978.[34]

The National Commission on Unemployment Compensation (NCUC) in 1980 recommended that UI coverage be extended to farm workers on the same basis as other workers, dismissing arguments that year-round farm workers do not need UI coverage, that migrant and seasonal farm workers (MSFWs) would in any event not work long enough to become eligible for benefits, and that requiring UI coverage would accelerate the decline of the family farm and speed-up mechanization (NCUC, 1980, p. 24). The NCUC noted that year-round workers can experience layoffs, that farm workers who also do nonfarm work might qualify for benefits if their farm work and earnings counted for determining UI eligibility, and that UI could help to stabilize the farm workforce by keeping experienced workers who might otherwise find permanent nonfarm jobs available to the industry.

The Commission on Agricultural Workers in 1992 made the same recommendation to eliminate the small farm employer exemption under UI. CAW found that seasonal farm workers, by the fact of their intermittent employment, experience the joblessness and income losses that the UI system is meant to mitigate. The CAW recommended that "agricultural employees should be provided with federal/state UI coverage that provides them with protection against unemployment that is comparable to that of other workers in the United States." CAW, dominated by farm employer representatives, cautioned that UI coverage of farm workers would require "close monitoring ...to ensure program integrity because many farm workers have multiple employers" (CAW, 1992, p. xxviii).

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[34]The National Commission on Unemployment Compensation (1980, 22) wrote that the 1976 UI amendments, which went into effect in 1978, extended coverage to 500,000 farm workers.

California Experience

California is the leading agricultural state, accounting for about 10 percent of the nation's farm sales and 30 to 40 percent of all U.S. farm workers. Since 1978, California has had practically universal UI coverage for farm workers.

Agriculture in California is a negative reserve industry. In 1992, for example, employers with the crop SIC 01 paid $2.8 billion in total wages, and 60 percent or $1.6 billion of these wages paid were subject to state UI taxes. Crop employers contributed $70 million--4.3 percent of their taxable wages--in UI taxes, but farm workers received $190 million, or about 3.5 times more in benefits than crop employers paid in UI contributions. Agriculture in California ranks with construction as one of the handful of industries in which UI benefits paid are 2 to 4 times employer UI contributions.

As the Commission considers small farm employer exemption, three points might be noted.

1. First, eight states, including the major farm labor states of CA, FL, and TX, already require that farm workers employed on smaller farms be covered by UI.

2. Second, extending UI coverage to more farm workers clearly increases farm worker earnings. In California, crop farmers paid total wages of almost $3 billion in 1992, and UI benefits added almost $200 million or 7 percent to farm workers' farm earnings.

3. Third, extending UI coverage to more farm workers at a time when the farm workforce includes ever more unauthorized workers raises several issues. It is alleged that some employers encourage or require employees to break the law by drawing UI benefits under one SSN while working for a substandard cash wage.

Unauthorized Workers and UI Benefits

Unauthorized workers raise a number of issues for the UI system. Most U.S. farm workers are legal immigrants, but the 10 to 30--and rising--percentage who are unauthorized workers raises the specter of employers increasingly making UI contributions on behalf of workers who are not eligible for UI benefits.[35] According to one national survey of crop farm

[35]"State laws implementing the unemployment compensation program must restrict the payment of compensation to aliens to those aliens who were lawfully admitted for permanent residence when employed, were

workers, about 12 percent of the unauthorized workers interviewed in the early 1990s applied for UI benefits.

The NCUC noted that the Unemployment Compensation Amendments of 1976 required states beginning in 1978 to deny UI benefits to illegal aliens, on the ground that they are not lawfully available for U.S. jobs (1980, p. 29). The NCUC recommended that this "FUTA requirement that States restrict eligibility of certain undocumented alien workers" for UI benefits be repealed (1980, p. 3). The Commission may wish to consider the impact of the fact that perhaps 10 to 30 percent of the UI contributions of farm employers are currently being made on behalf of workers who are not eligible for benefits.

There has been testimony in California that especially Farm Labor Contractors (FLCs) are abusing the UI system and violating labor standards laws by requiring farm workers to draw UI benefits under one name and SSN while working for a below-minimum cash wage. The employee may in this manner have a combined UI plus cash wage income that is greater than normal, and the FLC can pay low cash wages and avoid payroll taxes. The California Assembly Committee on Taxes and Revenues claimed in December 1993 that such behavior cost the state $111 million annually.[36]

The UI Exemption and other Farm Labor Laws

The UI exemption for small farmers is a reminder that agriculture is the last major industry still treated separately under many federal and state labor laws. Agriculture remains excluded from the NLRA and the overtime provisions of the FLSA. On the other hand, the federal MSPA law attempts to overcome some of the disadvantages of farm workers by specifying in some detail how workers are to be recruited and paid, permitting farm workers to seek damages in addition to workers compensation in the event that their injuries were caused by a material violation of MSPA, and grants farm workers a private right to sue their

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lawfully present for the purpose of engaging in the employment on which unemployment (FUTA) taxes were paid, or, were residing permanently in the United States under color of law when employed (section 3304(a)(14)(A) of the Internal Revenue Code of 1986). State case law at times has interpreted "permanently residing under color of law' more broadly for Unemployment compensation purposes than that term has been interpreted by Federal courts for purposes of AFDC." (U.S. House of Representatives, 1992).

[36]Hearing held December 8, 1993 in Sacramento.

employers for MSPA violations. Nonetheless, accounts of poor farm labor conditions persist, leading to proposals to strengthen MSPA protections.[37]

Most commissions that have looked at the farm labor law labyrinth have recommended that the United States should work toward equality for farm workers in all matters, from immigration to labor law.[38]

The H-2A Program;

History of Contract and Nonimmigrant Labor;

U.S. immigration policy has been based on the theory that all immigrants admitted to the United States should have the right to work here on an equal basis with American workers. This means that all workers--immigrants and natives alike--should be free to change jobs without fear of losing their access to the U.S. labor market, and that only a few public sector jobs and private sector jobs involving with national security should be restricted to U.S. citizens. These notions of a free labor market for all workers in the United States was violated by slavery, and by exceptions to immigration laws that permitted immigrants to arrive as indentured workers and as temporary workers. Most of these immigration exceptions were made for farmers.

Many first-wave immigrants to what were then British colonies came as so-called indentured servants: the cost of traveling across the Atlantic was equivalent to 4 to 6 months of a laborer's wages in England in 1776, and over a third of the white immigrants had to indenture themselves by promising to work for four or five years in the colonies that became the United

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[37]Rep George Miller (D-CA), the major author of MSPA in 1983, on March 2, 1993 introduced HR 1173, the "Agricultural Worker Protection Reform Act of 1993". According to Miller, HR 1173 would "Hold growers liable for violations committed by the farm labor contractors; eliminate distinctions between seasonal and migrant workers; make employers responsible for meeting all local, State, and Federal health and safety laws and regulations, including child labor laws; require crewleaders to post a performance bond to ensure payment of wages owed to farm workers; disqualify persons convicted of serious crimes from becoming crewleaders; require full disclosure to farm workers of all the terms and conditions of their employment; increase the penalties for growers and crewleaders who violate the act, and; require employers to provide child care if they have 25 or more employees, and provide field sanitation and protection from heat stress regardless of the number of employees." (Congressional record, March 2, 1993, p. E484.)

[38]It should be noted that many commissions recommend only partial convergence of farm and nonfarm labor laws. For example, the CAW in 1992 recommended that labor laws for farm and nonfarm workers converge, but a majority did not recommend that nonfarm FLSA standards be applied to farm workers, and a majority wanted the federal government to be prepared to take "immediate action" in the event of a farm labor shortage.

States[39] for the employer who paid the ship owner for their transportation (Lebergott, 1986, p. 185).

During the Civil War, labor shortages prompted a short-lived contract labor program. Employers pressed for a law to encourage the immigration of solo male workers, since immigrant families often moved west in search of free land. In 1864, an Act to Encourage Immigration--more commonly known as the Contract Labor Law--was adopted which allowed U.S. employers to recruit foreign workers and to pay their transportation to the United States. The unskilled workers recruited, in turn, were obliged to pledge up to one year's wages as repayment for their transportation (Briggs, 1992, p. 49-59). Fledging unions opposed the Contract Labor Law, and succeeded in having it repealed in 1868. However, the practice of importing foreign workers who were obliged after their arrival to work to repay their transportation costs continued until 1885, when the Alien Contract Law was amended to specifically prohibit the further entry of contract immigrant labor.

Between 1885 and 1952, there was no statutory basis for the admission of temporary foreign workers. Indeed, the Immigration Act of 1917 denied admission to all "persons...who have been induced ...to migrate to this country by offers or promises of employment," thus preventing the entry of immigrant and nonimmigrant contract workers. The 1917 Immigration Act also imposed a head tax on immigrants and excluded immigrants over 16 who could not read in any language.

California farmers, with "Food to Win the War" as a motto, persuaded the U.S. Department of Labor (DOL) in May 1917 to suspend the head tax and the literacy test in order to admit temporary Mexican farm workers legally. Farmers were permitted by DOL to recruit Mexican workers to work in the United States for up to one year. These Mexican workers had contracts which required them to remain in the employ of the farmer who recruited them or face deportation.[40] (Fuller, 1940, p. 19848).

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[39]The nation's first labor force data for 1800 put the U.S. workforce at 1.9 million, of whom 1.4 million were free workers and 74 percent of them were engaged in agriculture.

[40]This so-called "ninth proviso" exemption to Section 3 of the 1917 Immigration Law was extended to railroad maintenance workers and coal miners in June 1918. Between May 1917 and June 1920, some 51,000 Mexicans entered the United States under these exemptions, and 80 percent were farm workers (Fuller, 1940, p. 19853).

This immigration exception for agriculture was controversial. Herbert Hoover in 1918 argued for removing restrictions on Mexican immigration by asserting that "we need every bit of this labor that we can get and . . . we will need it for years to come." The Mexican Consul in Arizona, in the same year, noted that many Mexicans and Mexican-Americans in that state were unemployed, so that "there is an abundance of labor here and what is lacking is a good wage and above all good treatment." (Quoted in Kiser and Kiser, 1979, p. 14-15).

The Mexican workers admitted under these World War I immigration exceptions were supposed to be nonimmigrants, meaning that they were expected to return to Mexico when their seasonal jobs ended. However, many remained in the United States: the Mexican-born population in California tripled from 120,000 in 1920 to 368,000 in 1930, and additional Mexican workers came seasonally to California. Federal immigration laws in 1921 and 1924 that restricted immigration from Europe and other Eastern Hemisphere nations did not apply to Mexico, and the U.S. Border Patrol, established in 1924, did little to impede Mexican sojourners who migrated north to be seasonal farm workers.

The Bracero Program

During the 1930s, there was a widespread feeling that Mexican immigration contributed to an oversupply of labor that in turn held down wages and prevented unions from improving wages and working conditions, including in farm labor markets. Between 1929 and 1933, an estimated 400,000 Mexicans were returned to Mexico--more than immigrated in the 1920s--including many U.S. citizens, and their forced return discouraged other Mexicans from attempting to enter the United States during the Depression. The desperate conditions of California farm workers prompted a series of investigative reports which documented poor housing and working conditions, and these reports of farm labor conditions inspired John Steinbeck's book The Grapes of Wrath in 1939.

The year 1939 marked the high water point in concern about farm labor problems. A book by Carey McWilliams entitled *Factories in the Fields* and a doctoral dissertation by Varden Fuller entitled *The Supply of Agricultural Labor as a Factor in the Evolution of Farm Organization in California* demonstrated that California farms had more in common with the nonfarm factories which were being subjected to federal labor laws than to the family farms described in

Congressional debates to demonstrate that hired farm workers did not want or need the protections of labor laws. A subcommittee of the U.S. Senate Education and Labor Committee, headed by Robert LaFollette (D - WI), held extensive hearings on California farm labor problems, and concluded that California's large farms and their workers should be brought under these labor laws to correct the abuses that they identified.

These reports convinced most Americans that the farm labor market needed to be reformed, that farm workers employed on large farms should be brought under labor relations and protective labor laws, including UI. However, war intervened in 1941 and, instead of reforming farm labor markets, the wartime emergency was used to persuade the U.S. government to permit the importation of Mexican Bracero farm workers.

In the spring of 1942, California farmers predicted that there would be labor shortages for the fall harvest, and they called for the importation of between 40,000 and 100,000 Mexican farm workers in September. Reformers complained bitterly that there was no shortage of workers. Growers' cries of labor shortages were, they argued, "a mere repetition of the age-old obsession of all farmers for a surplus labor supply" (Quoted in Craig, 1971, p. 38-39). However, farmers won the right to import Braceros by arguing that crop losses caused by labor shortages would hamper the war effort, and 1,500 Mexican farm workers were brought to California in September 1942.

The Mexican government, sensitive about the conditions under which some of its nationals had previously worked in the United States,[41] and doubtful that there was a real labor shortage in U.S. agriculture, insisted that the U.S. government guarantee the contracts that farmers provided to Mexican workers, including round-trip transportation and the payment of wages equal to those of similar American workers (Craig, 1971, p. 41). The U.S. government agreed, and Mexican workers were admitted by establishing an exception to immigration laws for "native-born residents of North America, South America, and Central America, and the islands adjacent thereto, desiring to perform agricultural labor in the United States."

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[41]The Mexican government did not permit Braceros to be employed legally in Texas during the war years because of past abuses.

The Bracero program brought 5 million rural Mexicans to rural America over two decades in an "unprecedented experiment in inter-American labor migration." (Craig, 1971, p. 51). Many Braceros returned year-after-year, so that an estimated 1 to 2 million individuals participated, but the Bracero program did deepen the dependence of U.S. farmers on a workforce with no other U.S. job options, and institutionalized the dependence of many rural Mexicans on the U.S. labor market.

The Bracero program was small during the war years; admissions peaked at 62,000 in 1944, less than 2 percent of nation's 4 million hired workers. However, Braceros were concentrated on a few farms in a few states, where their impacts were significant. They were employed primarily in the southwestern states, with the majority employed in California, and then only on the largest farms: fewer than 50,000, or 2 percent of the nation's commercial farms, ever employed Braceros. Although the major crop changed during the life of the program, most Braceros picked cotton during the program's first years.

Braceros were not the only "external" workforce made available to farmers during World War II. The U.S. government offered the Japanese residents of western states who were interned in camps the choice of living in the camps or doing farm work. Many chose to work, sometimes on the same farms they had sold or given up to go into the camps. In 1944 and 1945, the U.S. government brought Italian and German prisoners of war to California to be farm workers. Finally, federal, state, and county prisoners were often made farm workers; a practice that continued until the late 1960s.

The Bracero program with the U.S. government as the contractor of Mexican workers lapsed on December 31, 1947, and there followed several years of informal and private U.S. employer recruitment of Mexican workers. Illegal immigration increased as Braceros learned they did not have to pay bribes to local Mexican officials to get on recruitment lists, and then pay additional bribes at Mexican recruitment centers in order to work in the United States. U.S. farmers were pleased because they could employ Mexican workers without government "red tape," such as having their housing for Braceros inspected and being required to offer them the minimum or government-calculated prevailing wage, whichever was higher.

The informal postwar recruitment of Mexican workers sent Mexicans streaming north illegally. Many were legalized after they arrived in the United States, in a process that came to be termed, even in official U.S. government publications, "drying out the wetbacks." (President's Commission, 1951). The number of aliens who were legalized after arriving and finding employment illegally far exceeded the number of Mexican workers that U.S. employers contracted legally in the interior of Mexico. In 1949, for example, about 20,000 Mexicans received contracts from U.S. employers at recruitment centers in Mexico and legally entered the United States as contract workers, while over 87,000 arrived illegally in the United States and then had their status legalized after they found jobs (President's Commission, 1951, p. 53).

A President's Commission on Migratory Labor was established in 1951 to determine whether U.S. agriculture needed Mexican immigrants. The President's Commission concluded that they were not needed: it recommended that "no special measures be adopted to increase the number of alien contract workers beyond the number admitted in 1950," which was 67,500 (p. 178). The United States, it argued, could produce food for the Korean War emergency by using its domestic work force more effectively. Furthermore, the Commission recommended that "legislation be enacted making it unlawful to employ aliens illegally in the United States" and that "legalization for employment purposes of aliens illegally in the United States be discontinued and forbidden" (p. 180).

.c3.The PL-78 Program:

These recommendations were not adopted. Growers tied their request for a new Bracero program to the nation's ability to win the Korean War and, in 1951, Congress enacted PL-78, the Mexican Farm Labor Program (Craig, 1971). This is the program that is usually meant when describing "the" Bracero program.

The PL-78 Bracero program sowed the seeds for contemporary Mexico-to-U.S. migration by permitting U.S. agriculture to expand without improving wages and working conditions, thus creating a demand-pull for Mexican workers as U.S. workers found better nonfarm jobs. As U.S. workers learned that they did not face Bracero competition in nonfarm labor markets, they abandoned the farm labor market for factories, and the Bracero share of the workforce

harvesting citrus, tomatoes, and lettuce soon surpassed 50 percent. Farm wages as a percent of manufacturing wages fell in California during the Bracero-dominated 1950s.

There was considerable illegal immigration alongside the rising number of legal Bracero entries. Between 1942 and 1964, there were 4.6 million Braceros admitted and 4.9 million Mexicans apprehended in the United States. The Mexican government was concerned during the late 1940s about its nationals going north illegally and, in the negotiations leading up to the PL-78 agreement, "The Mexican government, press, and citizen(sic) ... contended that the wetback exodus could be stopped only when [U.S.] employers were penalized for hiring them" (Craig, 1971, p. 75).

President Truman endorsed Mexico's plea for U.S. employer sanctions, but he could not persuade Congress to go along with penalties on U.S. employers who knowingly hired illegal aliens. Even though Bracero proponents argued that this legal side door would reduce illegal immigration, the facts proved them wrong; during the early 1950s, the number of Braceros and illegal immigrants increased together. Life magazine wrote a story: "Wetbacks Swarm In" in 1951. After the U.S. Attorney General toured the border area in 1953, the General of the Sixth Army was appointed INS Commissioner in 1954 with instructions to stop illegal immigration.

"Operation Wetback" was launched by the INS in 1954. In coordinated seeps, the INS was joined by state and local law enforcement authorities and Mexican authorities to round up and deport illegal Mexican immigrants (Craig, 1971, p. 128). As these sweeps spread to inland cities such as Kansas City and Chicago, many Mexicans returned on their own accord. In 1954, almost 1.1 million illegal aliens were apprehended. Simultaneously, the Bracero program expanded to accommodate more legal Mexican workers, so that the ratio of apprehensions to Braceros was reversed: in 1951-52, there were 5 apprehensions per Bracero admission; by 1956-57, there were 5 Bracero admissions per apprehension(Figure 2).

The U.S. government's regulation of the Bracero program was criticized by farmers and by farm worker advocates. Before farmers could employ Braceros, the U.S. Department of Labor (DOL) had to certify that American workers were not available to fill the jobs being offered to Mexican workers. In a curious protection for U.S. workers, farmers were required to guarantee Braceros—but not U.S. citizen workers—work at the minimum or prevailing wage

established by DOL for at least three-fourths of the length of the contract that the employer determined was the period of need.

There were also disputes over what the prevailing wage should be. The President's Commission in 1951 endorsed the idea that the presence of Braceros depressed wages by asserting that "farm wages . . . were inversely related to the supply of alien labor" (p. 59). Farmers allegedly preferred Braceros because, as "captive workers who were totally subject to the unilateral demands of employers," they worked hard and scared instead of agitating for higher wages or better benefits (Briggs, 1984, p. 101).

Bracero Program Impacts

The major impact of Braceros on U.S. workers was indirect. Braceros in the fields held down wages there, and a booming nonfarm economy offered higher wage urban jobs, so Mexican-Americans during the 1950s changed from a predominantly rural to a mostly urban population. The availability of Braceros permitted the southwestern states to become the garden states of the United States. In California, fruit and nut production rose 15 percent during the 1950s, and vegetable production rose 50 percent. New irrigation facilities expanded the acreage available to grow fruits and vegetables, the interstate highway system allowed produce to be shipped cheaply to eastern markets, and new plant varieties and packing technologies made California produce preferred to locally-grown fruits and vegetables in the eastern United States where most Americans lived.

This expansion of farm production in California was not accompanied by higher farm wages. The U.S. Department of Agriculture's average hourly farm wage rose 41 percent—slightly more than the 35 percent increase in consumer prices—from $.85 in 1950 to $1.20 in 1960. In contrast, average factory wages in California rose 63 percent, from $1.60 per hour in 1950 to $2.60 in 1960. Slowly rising farm wages and faster-rising factory wages drew American workers to factory jobs where there were no Braceros.

By the early 1960s, Braceros were essential to harvest only a few crops. In 1962, for example, 60 percent of the California's peak number of Braceros were employed to pick the cannery tomatoes that were processed into ketchup, and Braceros were over 80 percent of this crop's harvest workforce. As cotton and other geographically dispersed crops were

mechanized, the Bracero program became a non-immigrant program for a handful of farmers, and political support in the United States for its continuation weakened. When a mechanical tomato harvester was developed in California in the early 1960s, for example, one-fourth of the Braceros who were being admitted to the United States were no longer needed.

The Mexican government publicly did not oppose an end to the Bracero program. Even though most Mexican statements acknowledged that there would be adjustment costs if Mexicans could no longer work in the United States, stories of the abuse Mexican workers had endured in U.S. fields convinced many Mexicans that the program should be ended. Behind the scenes, however, the Mexican government was lobbying for the continuation of the program. In 1963, for example, the Mexican Ambassador opposed an end to the Bracero program for 5 reasons, including an expected increase in both illegal Mexican immigration and in permanent Mexican migration to the United States;[42] the loss of jobs and earnings for 200,000 Braceros and their, on average, 4 dependents; and Mexico's belief that the Bracero program had reduced discrimination against Mexicans and Mexican-Americans in the United States (Craig, 1971, p. 186-8). According to one scholar, "Mexico was largely responsible for the final extension" of the Bracero program, which was terminated on December 31, 1964.

The H-2 Program

Parallel to the Bracero program in the West, the U.S. government negotiated agreements with the governments of Jamaica, the Bahamas, St. Lucia, St. Vincent, Dominica, and Barbados in April 1943 to admit temporary unskilled farm workers for East Coast employers.[43] Between 1943 and 1947, this so-called British West Indies (BWI) program operated under the same authority as the Bracero program, PL 45. When that program lapsed in 1947, the BWI program was authorized as an exception to the Immigration Act of 1917. Growers who imported BWI workers could have come under the PL 78 Bracero program, but they preferred to make their labor importation program part of U.S. immigration law so that it would "be less subject to quick termination." (Briggs, 1992, p. 85).

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[42]Some 30,000 Mexican farm workers obtained immigrant visas in 1963, and 40,000 in 1964, beginning the process of substituting greencard immigrants for Braceros. (Craig, 1971, p. 187).

[43]East Coast growers preferred English-speaking BWI workers to Spanish-speaking Mexicans. (Briggs, 1992, p. 85).

East Coast growers got what they wanted in 1952.[44] The Immigration and Nationality Act of 1952 established 3 categories of temporary nonimmigrant workers in Section 101(a)(15)(H):

> persons of distinguished merit and ability (H-1),
> other temporary workers (H-2),
> and trainees (H-3).

The "other temporary workers" category admitted the most persons between 1953 and 1987. These H-2 workers could be admitted by the Attorney General "after consultation with appropriate agencies of the Government," and if a double temporary provision was satisfied--(1) the alien worker was coming temporarily to the Untied States to perform temporary services or labor and (2) "unemployed persons capable of performing such services cannot be found in this country." (Congressional Research Service, 1980, p. 59).

The 1952 H-2 provision did not limit H-2 admissions to agriculture, but it did establish the principle that U.S. workers have priority to fill vacant jobs. There was a dispute between farmers, who wanted agricultural H-2 admissions to be regulated by the USDA, and unions, who preferred DOL administration, and as a result admission was lodged by law in DOJ, and by regulation DOJ asked DOL to provide a certification that unemployed workers were not available to fill the vacant job.

The INS since 1953 has issued regulations that spell out the procedures for admitting H-2 workers. Employers make their initial application to a local office of the ES, and the DOL can, after it has reviewed the employer's application and recruitment efforts, issue a certification that there is likely to be a labor shortage. The employer wishing to import H-2 workers attached this DOL certification to the INS petition.

DOL H-2 Regulations for Farm Workers

The H-2 program differed from the Bracero program because it was a permanent part of immigration law, it had no geographic or occupational restrictions, and the Attorney General rather than DOL had the final word on whether foreign workers would be admitted--the DOL

[44]One unnamed observer noted that Mexico required U.S. employers to pay $44 for each Mexican worker they recruited. H-2 visa fees, by contrast, are based on the fees that sending nations charge U.S. citizens for analogous visas. Jamaica imposed no fee on U.S. citizens seeking temporary work there, so H-2 employers of Jamaicans paid no fees for H-2 visas.

opinion as to labor shortage is advisory only.[45] When the Bracero program was terminated in 1964, some farmers expected to import Mexican workers under the H-2 provisions of the INA. However, the Secretary of Labor published regulations in December 1964 that had the effect of making it difficult to import Mexican farm workers under the H-2 program.[46]

U.S. senators were outraged and, in a fight reminiscent of those that occurred during the Bracero years, an effort to transfer the authority to certify the need for alien farm workers from the Department of Labor to the Department of Agriculture failed in the Senate only because the Vice-President cast the deciding vote against the transfer (Congressional Research Service, 1979, p. 42). The fight against DOL was led by Senator Holland of Florida, who attacked "this idealistic, evangelistic Secretary of Labor, who thinks he has authority to set wages." (Congressional Research Service, 1980, p. 67). Secretary Wirtz noted that the use of legal nonimmigrant foreign farm workers was reduced by 83 percent between 1964 and 1965.

The 1964 DOL H-2 regulations remained in effect until the late 1970s. When the INA was amended in 1965, the AFL-CIO unsuccessfully attempted to eliminate the importation of H-2 farm workers. However, the reports accompanying the 1965 INA amendments made it clear that H-2 workers would earn no priority in the preference system through which legal immigrants were to be admitted.

H-2 Program Litigation

The H-2 program was the subject of litigation and debate during the 1970s. In some cases, DOL refused to certify that there was a shortage of U.S. farm workers, and the grower wishing to import H-2 workers then went to a federal judge to obtain an order compelling the INS to nonetheless admit H-2 workers in order to avoid crop losses. In 1977, for example, Mexican H-2 farm workers were admitted into Presido Texas, reportedly after the intervention

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[45]Under the Bracero program, DOL both determined whether Bracero workers were needed and then ensured that the contracts between U.S. employers and foreign workers were honored.

[46]Secretary of Labor Wirtz interpreted the decision to terminate the Bracero program as signifying congressional intent to reduce or eliminate the presence of temporary foreign workers in U.S. agriculture. Under December 19, 1964 DOL regulations, U.S. employers wishing to receive DOL certification to import H-2 workers had to attempt to recruit U.S. workers at a DOL-established Adverse Effect Wage Rate (AEWR), and to offer such workers free housing, round-trip transpiration, and then receive e certification to employ H-2 workers for a maximum of 120 days, because "the only justification for bringing in labor is to meet the peak conditions the highly seasonal agricultural industry." (Congressional Research Service, 1980, p. 65).

of President Carter, despite the employer's failure to offer housing, which resulted in DOL refusing to certify that there was likely to be a labor shortage (Congressional Research Service, 1980, p. 62).

Most of the grower criticism was directed at DOL's labor certification process. Farm employers argued that the ES interstate clearance system, which by regulation farmers must use to attempt to recruit American workers, imposed on them a costly burden that rarely produced acceptable workers. Farm worker advocates argued that DOL issued certifications of farm labor shortages when there were no such shortages. During the late 1970s, when there were extensive studies, hearings, and litigation, it was estimated that the total public and private costs of administering the then H-2 program might equal one-fourth of the wages of H-2 workers, which were about $60 million annually.[47]

After DOL denied a grower's request for certification of the need for H-2 workers, growers often asked federal district judges to issue injunctions to require that their need for H-2 workers be certified to avoid crop losses. According to one critical review of such practices, "District courts routinely granted these requests through preliminary injunctions that prohibited the Department of Labor from denying certification. These injunctions were often issued in circumstances that suggested bad faith by the growers." (Coleman, 1989, p. 197).

By the time these cases were resolved, the H-2 workers had long departed from the United States. The H-2 program became increasingly mired in controversy, especially after the Legal Services Corporation established rural legal services programs in the 1970s, and they sued DOL for certifying that there were likely to be shortages of farm workers that justified H-2 admissions. In testimony and statements to various government agencies, commissions, and Congress, legal services attorneys called for the elimination of the H-2 program on the grounds that admitting foreign workers depressed wages and working conditions for U.S. workers. This sentiment was well-expressed by a Migrant Legal Action Program in 1981 testimony on the SCIRP:

> I believe that the H-2 program should be terminated....access to H-2 workers has been governed more by politics and tradition than by demonstration of

[47]There are no published data on the earnings of H-2A workers. This earnings estimate assumes that 20,000 workers each earned $3,000.

> need...Agricultural employers seeking harvest workers could satisfy their labor needs with U.S. workers if wages and working conditions were brought up to 20th century standards. (U.S. Senate, Committee on the Judiciary, 1981, p. 316)

Farm worker advocates repeated the call to eliminate the H-2 program in the dozens of hearings held on immigration reform and farm labor in the early 1980s (Camacho de Schmidt, 1983). The California Rural Legal Assistance Program representative repeated this recommendation to repeal the H-2A program to the Council in San Francisco on January 11, 1994.

A journalist who studied the controversy over whether U.S. citizen Puerto Ricans, or H-2 Jamaicans, should pick apples in MD, WV, and VA in the late 1970s reached the conclusion that Congressional policy guaranteed litigation: growers have "the possibility of hiring foreign labor" but at the same time, Congress insists that "the employment of aliens have no adverse effect on domestic wages." Cowan, 1978, p. 45).

The H-2 Program before Immigration Reform

A broader interest in the H-2A program developed in the early 1980s as a result of proposed reforms to deter illegal immigration: if such immigration were halted, then it was assumed that programs through which legal temporary foreign workers arrive would expand. There were numerous studies and hearings on the potential of an expanded H-2 program to act as a substitute for illegal immigrant workers in agriculture and other industries.

The H-2 program was roundly criticized in the late 1970s and early 1980s, but most recommendations were to maintain the program with only minor changes.[48] The Select Commission on Immigration and Refugee Policy, for example, acknowledged in 1981 "the inadequacies many people find with regard to the H-2 program, [but]the Commission finds

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[48]Secretary of Labor Ray Marshall asked the National Commission for Manpower Policy to review the H-2 program in 1978. The NCEP commissioned two studies: that by North and Label recommended against an expansion of the H-2 program, and that by Reubens recommend that the program be modified and expanded. NCEP Chairman Eli Ginzberg in a letter to Secretary Marshall dated May 1, 1979 recommended against an expansion of the H-2 program and, in the case of farm employers, recommended that DOL attempt to phase out employer dependence on H-2 workers "by a declining allowance[of H-2 workers]reinforced with a special tax." Ginzberg suggested that such a phase out might be accomplished over three years.

In 1981, Marshall opposed President Reagan's proposal to admit 50,000 freed agent Mexican workers, and noted that it was very difficult for DOL to administer the H-2 program because DOL had no simple yet reliable test of domestic worker availability and employers preferred the foreign workers that "friendly judges" overrule DOL and admit.(Marshall, 1981, p. 17).

that a continuation of the program is necessary and preferable to the institution of a new one." (SCIRP, 1981, p. 227).[49]

The H-2 program figured prominently in the debate over immigration reforms to reduce illegal immigration because: (1) it was believed that there were 350,000 illegal immigrant farm workers in the early 1980s and (2) after immigration reforms were enacted, and illegal immigration reduced, some farm employers would be encouraged to switch to hiring H-2 farm workers. During hearings on the H-2 program in the early 1980s, the H-2 program was praised and criticized. The spectrum of opinions can be captured by the titles of sample materials printed in Congressional reports: from "The H-2 Foreign Labor Program: The Record of Employer and U.S. DOL Abuse Justifies its Elimination" (U.S. House of Representatives, 1984, p. 264) to a grower's call for an "E-Z Foreign Farm Worker Program."

The cost savings that accrued to employers because of the FUTA and FICA exemptions were discussed mostly by those who examined the program as a possible model for an expanded guestworker program. USDA analysts in 1982 did an analysis of the savings that accrue to H-2 employers because of these exemptions (Pollack et. al., 1982). According to their assumptions about hours worked in 1980, farmers who used H-2 workers paid them almost $30 million in 1980, and saved $2.5 million or 8.3 percent of the wages they would have paid if the earnings of H-2 workers had been subject to FICA and FUTA. Perhaps the most interesting part of their analysis of these payroll tax savings is their distribution: more than 80 percent of the savings accrued to Florida sugarcane growers, even though they accounted for only half of the certifications(Figure 3).

The H-2 Program after Immigration Reform

The H-2 program was not eliminated in the Immigration Reform and Control Act (IRCA) of 1986. Instead, DOL regulations governing the labor certification process were

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[49]SCIRP recommended, by a vote of 14-2, three changes in the H-2 program. In addition to requiring that employers pay FICA and FUTA taxes on the earnings of the H-2 workers they employ, SCIRP recommended that the H-2 application process be streamlined so that farm employers would not have to apply 80 days before the date they expected to need workers (IRCA lowered to 60 days the minimum time before the need date that the employer must file a request for labor certification with a local ES office) and SCIRP recommended that "GOVERNMENT, EMPLOYERS AND UNIONS SHOULD COOPERATE TO END THE DEPENDENCE OF ANY INDUSTRY ON A CONSTANT SUPPLY OF H-2 WORKERS", although SCIRP note that adopting these recommendation should not preclude A SLIGHT EXPANSION OF THE PROGRAM (emphasis in original).

modified slightly and written into IRCA. The H-2A program has operated under IRCA since June 1, 1987. The flow chart in the appendix the summarizes the procedure through an employer's application for labor certification is reviewed by DOL.

The H-2A program was expected to expand significantly after IRCA. It did not: the number of H-2A certifications rose about 20 percent, from an average 21,000 between 1984 and 1986 to an average 25,000 between 1987 and 1989, and has since 1989 fallen about 30 percent to less than 18,000 in 1993.

The H-2A program was considered most recently by the Commission on Agricultural Workers (CAW). CAW noted the apparent contradiction of "an oversupply of workers in most agricultural labor markets[alongside]...instances of crop-specific local labor shortages." (CAW, 1992, p. xxvi). The CAW attributed the general oversupply of farm workers to the finding that "employer sanctions have been ineffective at preventing, and have not significantly curtailed, the employment of unauthorized workers in agriculture." (CAW, 1992, p. xxi). Nonetheless, the CAW recommended that a contractual worker program be continued under which employers who receive a certification that they are likely to face labor shortages are permitted to import temporary farm workers. However, the CAW recommended that Congress make the same H-2 provisions applicable to farm and nonfarm employers requesting temporary foreign workers.[50]

This CAW recommendation was made in the context of a changing farm labor market. The CAW was charged with evaluating the effects of IRCA's agricultural provisions on U.S. farm workers and farmers, and its deliberations were shaped by the evolution of the farm labor market. Six of the 11 CAW commissioners represented or had lobbied on behalf of farm employers and, at the outset, these six commissioners seemed to be divided evenly between those who thought that the H-2A program would be the major foreign farm worker program of the 1990s, and those dedicated to ensuring that there would be a non-DOL certification program available through which farm employers could lawfully obtain foreign workers.

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[50]Three Commissioners filed statements disagreeing with this recommendation that alien farm and nonfarm workers be admitted under the same law and regulations, and one Commissioner called for the abolition of the H-2A program on the grounds that it represents a form of "institutionalized slavery" under which the United states takes "people's labor as a contribution to our society, and [then] den(ies) them the benefits the society offers." (Statement of Huerta, 1992, p. 152).

As it became clear by 1991 that IRCA facilitated rather than slowed illegal immigration, the emphasis of the CAW turned from the rationale for alien agricultural labor programs to three concerns: ensuring that government failure to control illegal immigration, rather than farm employers, was blamed for deteriorating farm wages and working conditions; blaming government agencies for not doing their job of matching workers and jobs, enforcing labor laws, and teaching farmers modern personnel practices; and urging the federal government to provide more services to farm workers so that they and their children were not disadvantaged by their occupation.

CAW positions toward the H-2A program also evolved. In 1990 hearings, when there was still the expectation that the INS might begin to aggressively enforce sanctions and thus deter the employment of illegal alien farm workers, there was a great deal of testimony about the need for a fully-funded ES to seek U.S. workers, the need for subsidized farm worker housing, and arguments about whether litigation by rural legal service attorneys deterred farmers from turning to the ES for workers.

By 1991 and 1992, when it was clear that the H-2A program would shrink rather than expand, the majority of CAW Commissioners was willing to relegate the H-2A program to a secondary role. In somewhat awkward phrasing, CAW "found" that, despite "an oversupply of workers in most agricultural labor markets...there continue to be instances of crop-specific labor shortages[which]encourage some employers in some areas to rely on the U.S. DOL-administered H-2A program." (CAW, 1992, p. xxvi).

Pro-H-2A Commissioners offered an equity argument to "reform" the H-2A program. Since CAW was recommending that the farm worker exclusion be eliminated in the federal UI system, and that farmers be required to provide Workers Compensation for farm workers in the 20-some states that do not require such coverage, the Commission recommended that Congress "reexamine the [H-2A program]...with the goal of having the same program available to agricultural and nonagricultural employers, both in law and regulation." (CAW, 1992, p. xxvi).

The H-2A Program Today

The H-2A program[51] permits U.S. farm employers who anticipate a shortage of farm workers to bring into the United States temporary nonimmigrant aliens to perform agricultural labor of a temporary or seasonal nature, i.e., both the workers and the work must be temporary, and temporary is usually construed to mean less than 12 months[52]. A farm employer wishing to import H-2A farm workers must submit a petition to the Immigration and Naturalization Service (INS) which includes the number of workers for whom H-2A visas are sought and the port through which they will enter the United States. The INS forwards accepted employer petitions to the Department of State (DOS) consulate in that country, and that consulate issues H-2A visas to the workers named in the employer's petition.[53] The H-2A workers then present their H-2A visas at the U.S. port of entry.

The INS does not usually accept such employer petitions unless they are accompanied by a certification from the U.S. Department of Labor (DOL) that there are not sufficient workers who are (1) "able, willing, and qualified, and who will be available at the time and place needed to perform the labor or services involved in the petition, and (2) the employment of the alien in such labor or services will not adversely affect the wages and working conditions of workers in the United States similarly employed."[54] U.S. employers wishing to convince DOL that these two criteria are satisfied must attempt to recruit U.S. workers under regulations that include the employer offering at least a DOL-stipulated hourly or piecerate wage, they must prepare an interstate Employment Service (ES) clearance system order to seek workers in other states, and

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[51]The statute reads: A petition to import an alien as an H-2A worker (as defined in subsection (i)(2)) may not be approved by the Attorney General unless the petitioner has applied to the Secretary of Labor for a certification that—

(A) there are not sufficient workers who are able, willing, and qualified, and who will be available at the time and place needed, to perform the labor or services involved in the petition, and

(B) the employment of the alien in such labor or services will not adversely affect the wages and working conditions of workers in the United States similarly employed." SEC. 218. 18 U.S.C. 1188(a).

[52]There are exceptions, including the 1100 H-2a sheepherders (one-third of whom are employed in California)—they receive 3-11 month H-2a work visas.

[53]The DOL and INS petitions are not always accompanied by the names of workers that the employer wants to import. In many cases, the employer sends the names directly to the consulate in the workers' country of origin.

[54]Federal Register, June 1, 1987, 20496, 20 CFR Parts 654 and 655. T According to the statute, "the Secretary of Labor may require by regulation, as a condition of issuing the certification, the payment of a fee to recover the reasonable costs of processing applications for certification."

they must offer free housing to U.S. and H-2A workers.[55] Most materials on the H-2A program focus on the process through which employers obtain DOL certification of a labor shortage; a 1982 manual prepared for farm employers considering requests for H-2A workers, for example, mentions the role of INS and DOS only in passing (Holt, 1982).

The H-2A program has since 1989 been shrinking. The continued spread of "documented illegals" throughout rural America, and the mechanization of the Florida sugarcane harvest,[56] which accounted for 35 to 50 percent of the H-2A jobs certified before IRCA, suggests that H-2A certifications and admissions will continue to decline in the 1990s.

Unemployment Insurance and Farm Workers

The Social Security Act of 1935 established the Unemployment Insurance program to partially replace the lost earnings or workers who, through no fault of their own, lost their jobs. The UI system is funded by an employer-paid payroll tax; 1939 amendments named this the Federal Unemployment Tax Act (FUTA). In states that had an approved system for paying UI benefits, employers could obtain a credit for up to 90 percent of the FUTA.[57]

Agricultural workers were excluded from UI coverage in the 1935 act, and the definition of agricultural labor was broadened in 1939 to consider as agricultural labor certain agricultural processing and marketing activities that were performed on the farm, or in an off-farm facility but involved handling mostly products produced on the farm that also owned the packing facility. Both fieldworkers and some packinghouse workers are considered farm workers

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[55]Farm workers in over 20 states do not have to be covered by workers compensation insurance. Employers in such states wishing to employ H-2A workers must "provide, at no cost to the worker insurance Covering injury and disease arising out of and in the course of the worker's employment which will provide benefits at least equal to those provided under the State workers' compensation law for comparable employment."

[56]The number of H-2A sugarcane workers fell to 2000 in 1993-94 from 11,000 in 1989. Only one company, U.S. Sugar, continues to hand-cut sugarcane with H-2A workers. Some speculate that the reason has more to do with the company's desire to maintain access to H-2A workers to pick oranges on the 30,000 acres of trees planted in remote areas of southwestern Florida than the stated reason: because harvesting machines would get bogged down in the area's muck soil.

[57]For example, in California in 1994, the maximum state UI tax is 5.4 percent, so that most farm employers face a 6.2 percent state and FUTA tax on all of the wages they pay to seasonal farm workers. In 1992, California crop employers(SIC 01) paid $2.8 billion in total wages, and 58 percent or $1.6 billion of these wages were taxable for UI purposes. The average employer contribution was 4.3 percent of taxable wages, or 2.5 percent of total wages paid.

under the Fair Labor Standards Act (FLSA), the major federal law regulating minimum wages, overtime, and child labor. The FLSA has a primary and a secondary definition of agriculture:[58]

> "'Agriculture'" includes [*primary definition*] farming in all its branches and among other things, includes the cultivation and tillage of the soil, dairying, the production, cultivation, growing, and harvesting of any agricultural or horticultural commodities (including commodities defined as agricultural commodities in section 1141j(g) of Title 12), the raising of livestock, bees, fur-bearing animals, or poultry, and [*secondary definition*] any practices (including any forestry or lumbering operations) performed by a farmer or on a farm as an incident to or in conjunction with such farming operations, including preparation for market, delivery to storage or to market or to carriers for transportation to market.[59]

The National Labor Relations Act (NLRA) also excludes agricultural laborers. Although the NLRA does not define the term agricultural laborers, Congress has specified in appropriations legislation that agricultural laborer is to be understood as it is defined in the FLSA.[60]

During the 1960s, agricultural labor was in the limelight. In the early 1960s, there was debate over whether to terminate the Bracero program, whether to help U.S. farm workers trapped in the "migrant stream", and whether to extend NLRA coverage to farm workers. The Senate Subcommittee on Migratory Labor was considering a number of bills to deal with child labor, housing for migrant workers, and crew leader registration, when Senator Harrison Williams (D-NJ), who chaired the committee, was approached with the suggestion to substitute a federally-funded service such as health care to ameliorate the plight of farm workers rather trying to overcome farmer opposition to stricter regulation of the farm labor market. This strategy was adopted, and in September 1962 Congress passed without dissent a simple and straightforward bill adding a new section 310 to the Public Health Service Act. The law authorized up to $3 million "for paying part of the cost of . . . family health service clinics for domestic agricultural migratory workers and their families," as well as other special projects.[61]

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[58]Farmers Reservoir & Irrigation Co. v. McComb, 337 U.S. 755, 762-63 (1949).

[59]29 U.S.C. § 203(f) (1988).

[60]29 U.S.C. § 152(3) (1988). Bayside Enterprises, Inc. v. NLRB, 429 U.S. 298, 300 & n.6 (1977). The Internal Revenue Code also uses a similar definition of agriculture. 26 U.S.C. § 3121(g) (1988).

[61]Pub. L. No. 87-692, § 310, 76 Stat. 592 (1962). The background is recounted in Helen L. Johnston, Health for the Nation's Harvest: A History of the Migrant Health Program in its Economic and Social Setting 135-39 (1985).

domestic agricultural migratory workers and their families," as well as other special projects.[61]

The United Farm Workers (UFW) joined an August 1965 strike by California table grape harvesters, and then launched a series of consumer boycotts that resulted in 180 contracts covering 40,000 jobs by March 1973, when the UFW claimed 67,000 members who were employed at least one day on California farms. The UFW joined other farm labor reformers in calling for the end to the exclusion of agricultural labor from protective labor legislation and, beginning January 1, 1972, states were required to extend UI coverage to farm workers[62] employed by farm employers with 8 or more employees in each of 26 different weeks during the year. Once a farm employer crossed this employment threshold and was brought into the UI system, then all of the farm's employees were eligible for UI benefits if they could satisfy state eligibility requirements.

The major expansion of UI coverage to farm workers came on January 1, 1978.[63] Amendments approved in 1976 extended UI coverage to an estimated 500,000 farm workers employed on farms that (or by "persons" who) (1) paid cash wages of $20,000 or more for agricultural labor during any calendar quarter of the current or preceding calendar year or (2) employed 10 or more individuals for a total 20 or more days, with each such day being in a different calendar week. Since most employers who employ 10 or more workers also pay $20,000 or more in annual farm wages, the 10-20 rule is the operative factor in most cases.

These UI amendments clarified the distinction between farm employers and independent crew leaders or farm labor contractors (FLCs) who bring crews of farm workers to farms: a crew leader/FLC can be considered the employer for UI purposes if he/she holds a DOL FLC registration certificate and acts as an employer by hiring and firing workers. According to the 1980 National Commission on Unemployment Compensation (NCUC), 47

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[61]Pub. L. No. 87-692, § 310, 76 Stat. 592 (1962). The background is recounted in Helen L. Johnston, Health for the Nation's Harvesters: A History of the Migrant Health Program in its Economic and Social Setting 135-39 (1985).

[62]These 1970 amendments excluded from a farm's employment for the purposes of determining whether an employer had 8 or more workers in each of 26 different weeks crew leaders or farm labor contractors and their employees.

[63]PL 94-566.

states adopted this federal standard for coverage; California, MN, and RI adopted more inclusive farm worker coverage criteria.[64]

The 1980 NCUC discussed two issues surrounding the extension of UI coverage to more farm workers: cost and FLCs. Seasonal farm workers tend to draw more in UI benefits than their employers pay in UI tax contributions--in CA in 1992, for example, UI benefits paid to agricultural employees--the employees of employers with SIC codes 01, 02, and 07--totaled $356 million, while employer UI contributions were only $139 million. In CA, construction and food processing had similar ratios of 2.5 to 3.5 dollars in UI benefits paid for each dollar of employer contribution. The NCUC argued in 1980 that expanding UI coverage to workers employed on farms with 4 workers in 20 weeks, or a $5000 in annual payroll, would not significantly change the cost of UI coverage for farm workers, since workers employed by smaller employers are less likely to claim UI benefits.[65]

The ACUC report noted that the amendments extending coverage to farm workers employed on farms that satisfied the 10-20 rule also exempted until January 1, 1980 FUTA coverage of the earnings of H-2 workers. Public Law 96-84 in 1980 extended for two more years the FUTA exemption of the earnings of H-2 worker, but it provided that the labor performed by H-2 workers and their earnings should be included to determine whether the farm employer is subject to FUTA coverage, so that, for example, a farm with 5 U.S. and 5 H-2 workers in each of 20 weeks must pay UI taxes on the earnings of the U.S. workers.

There have been few recent estimates of the cost or desirability of extending UI coverage to workers employed on smaller farms.[66] The data in Table 1 indicate that in 1990, about 150,000 agricultural reporting units paid almost $20 billion to an average of almost 1.5 million

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[64]California required agricultural employers of one worker and wages of $100 or more in any quarter to pay UI taxes, MN required UI coverage of farm employers who satisfied a 4-20 rather than the federal 10-20 criterion, and RI extended UI coverage to farm employers with one or more workers employed at any time.

[65]National Commission on Unemployment Compensation. (Final Report, July 1980, p. 23.)

[66]It appears that farm workers are often made eligible for special or emergency benefits. For example, as a result of summer 1993 floods in the midwest, an "estimated15,000 farm workers... in over 180 counties, in the seven States" were left jobless. Due to exemption under the law, farm workers are not eligible for assistance under regular unemployment compensation. Also due to FEMA's restrictive definition of employment, many farm workers are excluded from disaster unemployment compensation coverage because they have not actually started their farmwork at the time of the disaster. As a result, a farm worker cannot rely on the normal benefits for help in either the immediate or foreseeable future." (Congressional record, July, 27, 1993, p. H5116).

In this case, the Secretary of Agriculture was authorized to extend emergency benefit assistance to farm workers.

covered workers. Not all of these employers, employment, and wages paid were paid by farms to farm workers, since some of the agricultural service firms are pet veterinarians and landscape and gardening services. However, the table does indicate that UI-covered agricultural employment and wages are concentrated in a few states: about 30 percent of the UI covered agricultural wages paid in 1990 were paid in California, over 50 percent were paid in 5 states (CA, FL, TX, WA, NY), and almost 70 percent were paid in the top 12 states that each accounted for 2 percent or more of UI-covered wages paid.

The wages paid by agricultural employers subject to UI coverage increased much faster than UI-covered agricultural employment between 1980 and 1990--wages paid increased by 115 percent, versus a 39 percent increase in UI-covered agricultural employment. A ranking of states by their 1980-90 increase in UI-covered agricultural wages indicates that a diverse group of states which continue to exempt small farmers from the UI system had the largest increase in UI-covered wages.

Farm Workers and UI in California

California has since January 1, 1978 had practically universal coverage of farm workers under the state's UI system; all farm employers who pay $100 or more in annual wages must obtain a UI-tax reporting number and make UI contributions on the first $7000 of each employee's earnings. Data are not available for the first several years of universal UI coverage in California agriculture, but over the decade 1983-92, California, crop, livestock, and agricultural service employers paid an average $5 billion annually in total wages, and $3 billion in taxable wages, indicating that two-thirds of the total wages paid in California agriculture represented the first $7000 of worker earnings.

The ratio of taxable to total earnings has been declining for workers employed in California agriculture and in nonfarm industries, a reflection of rising earnings and a fixed $7000 cap on the earnings on which UI-contributions must be paid, but the ratio of taxable to total earnings in agriculture, 56 percent in 1992, was exactly twice the 28 percent ratio for all UI covered workers in the state (Figure 4 and Table 2).

Agriculture in California is a negative reserve industry, which means that unemployed workers receive more in UI benefits than the UI contributions of agricultural employers.

Between 1983 and 1992, agricultural employers paid an average $114 million in UI contributions, while unemployed farm workers were paid an average $259 million in UI benefits (Figure 5). The gap between agricultural benefits paid and employer contributions reached its highest-ever level of $250 million in 1991, most likely a reflection of a December 1990 freeze, a drought in 1991, and confidence on the part of newly-legalized aliens that receipt of unemployment insurance would not jeopardize their status.[67]

The relationship between UI benefits paid and employer contributions can be examined by calculating the ratio of benefits to contributions by commodity. Figure 6 shows that the ratio of UI benefits paid to employer contributions varies by commodity, and that the ratio of benefits paid to employer contributions peaked at over $3 in 1991 for crop and agricultural service workers.

There were actually three years in which the ratio of benefits paid to employer contributions surged: 1983, 1986, and 1991. The high 1983 and 1991 ratios reflect changes in farm employment due to weather and farm policies: in 1983, drought and the Payment-in-Kind program idled many farm workers, and in 1991 a freeze and drought had the same effect of reducing the number of farm jobs available.

The 1986 surge is more puzzling, since the value of farm production reached a new high of $15 billion in that year. The explanation for the high ratio in 1986 probably lies in worker behavior rather than production changes: in 1987, workers obtained 14 percent less benefits, while employers paid 15 percent more in contributions. Some have speculated that fewer workers applied for UI benefits in 1987 and 1988 because they feared--wrongly--that receipt of UI benefits could jeopardize their applications for legal immigrant status.

Charts 4 and 5 demonstrate a much-discussed trend underway throughout U.S. agriculture that has as yet uncertain implications for the UI system: the tendency of farm employers to hire more workers through Farm Labor Contractors (FLCs) and similar intermediaries. The value of agricultural production in California rose about 20 percent between 1986 and 1992. The number of crop reporting units in California's UI reporting system

[67]Between 1989 and 1991, UI benefits paid to unemployed agricultural workers rose by 60 percent, while employer contributions rose by 1 percent. Between 1991 and 1992, UI benefits paid fell by 4 percent, while employer contributions rose by 17 percent.

rose in 1986, but has since fallen by almost 2000 from its 1988 high of 19,500. The number of agricultural service reporting units, by contrast, rose from 10,200 in 1986 to an almost 14,000 in 1991-92.

Figure 7 presents a more dramatic picture of the shift from hiring farm workers directly to hiring them through agricultural service firms such as FLCs. Average UI-covered employment rose by 8 percent between 1981 and 1992 to 420,000, but crop and livestock employment fell by one-sixth, while agricultural services employment rose by over 50 percent to account for over half of all California's agricultural employment. Although agricultural services employment began its significant rise in 1984, the big jumps were in 1987 and 1988, the years when IRCA was being phased in, when some farm employers decided to turn the paperwork of verifying each newly-hired worker's right to work in the United States and the risks of enforcement over to FLCs, who could supply farm workers and cover these risks at about the same overhead cost that a farmer would incur.

Part 2. Farm Workers in U.S. Agriculture

U.S. Agriculture

Agriculture is the oldest and most widely-dispersed industry in the United States. However, the farmers and farm workers who produce food and fiber are largely invisible to most Americans: about 2 percent of the nation's population live on farms, and 2 percent of the nation's wage and salary workers are employed on farms.[68] Most Americans do not know any farmers or farm workers; they see agriculture only through the lens of a grocery store.

Farmers and farm workers are considered the keystone, but farming is actually the smallest part of the 3-part food and fiber sector. The so-called input sector includes banks, chemical companies, and equipment manufacturers that supply agriculture with credit, fertilizers, and machinery. The second part is the production of crops and livestock on farms, and the third--the largest--are the trucking, retailing, and restaurant activities that process and distribute food and fiber to consumers. There were 21 million Americans employed in this food and fiber sector of the American economy in 1990, or 1 in 6 American workers(Box 1).

Agriculture is an industry in which the United States is a world leader. The most important expression of this U.S. leadership is at the grocery store: only about 10 percent of what Americans spend is devoted to food, versus 20 percent in Germany, 36 percent in Japan, and 51 percent in India (U.S.. Statistical Abstract, 1992, p. 833). The United States is also a major food exporter: exports account for about one-fourth of annual farm production, and farming is one of the few sectors of the American economy that has run a trade surplus for decades.

U.S. Farm Labor Policies

Farmers are generally held in high esteem. Thomas Jefferson, the third President, advocated an agrarian ideology that made farmers the backbone of democracy. In his Notes on

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[68]In 1990 there were 4.6 million farm residents, 1.4 million farm families, and 2.1 million farms. Farm worker data are even more confusing: there were an average 900,000 farm workers employed during each month of 1990, according to the Current Population Survey, the source of most labor force data. But farmwork is seasonal, and the number of individuals who are employed on farms sometime during a typical year is about three times larger, or 2.5 to 3 million (Statistical Abstract, 1992, p. 642-4).

Virginia. Jefferson wrote that "Those who labor in the earth are the chosen people of God...corruption of morals in the mass of cultivators is a phenomenon of which no age or nation has furnished an example" (quoted in Koch and Peden, 1944, p. 280). According to this agrarian ideology, agriculture is the most basic and important industry in the nation, rural life is superior to urban life, and self-sufficient family farmers are the guarantors of democracy. This ideology continues to influence American attitudes and policies today, helping to explain, for example, why farming is described as both a business and an exemplary way of life.

For most of American history, there have been more farm workers than farmers, but they are largely silent partners in the agricultural success story. Farm workers have been near the bottom of the U.S.. job ladder in pay and status since colonial times. There are several reasons. Under the agrarian ideology of Thomas Jefferson, there was no place for a permanent class of farm workers: farm workers were simply hired hands learning how to farm and saving enough to buy their own farms. A 1939 Congressional statement summarized this view:

> The habits and customs of agriculture of necessity have been different than those of industry. The farmers and workers are thrown in close daily contact with one another. They, in many cases, eat at a common table. Their children attend the same school. Their families bow together in religious worship. They discuss together the common problems of our economic and political life. The farmer, his family, and the laborers work together as one unit. In the times of stress, in the handling of livestock or perishable agricultural commodities, of impending epidemics and at many other times the farmer and laborer must stand shoulder to shoulder against the common enemy. This develops a unity of interest which is not found in industry (quoted in Schwartz, 1945, p. 4).

Some farm workers married the farmer's daughter and become farmers, but most did not. Instead of farm workers climbing the agricultural ladder to farm ownership, some of the nation's persisting social problems can be traced agricultural labor policies. Slavery was the "peculiar institution" developed in the south to assure plantations a supply of farm labor. In the west, the search for seasonal workers usually involved immigrants. Chinese immigrants were the first to be imported, and they were followed by Japanese workers, Filipinos, Dust Bowl refugees during the 1930s, and Mexicans since the 1940s.

Farm workers today are mostly immigrants, and immigrants are increasing reshaping the farm labor market. The most important farm labor development of the 1990s is the spread

of Mexican immigrants throughout U.S. agriculture. This "Latinization" of rural America may mark yet another instance in which what happens first in California eventually spreads throughout the country.

Farm Employment

U.S. farmers employ about 2.5 million individual s each year to fill an average 1 million jobs on the nation's farms. About one-third of all farm worker activity is in California, where farmers employ about 900,000 individuals for an average 350,000 farm jobs. In the nation and in California, three workers, on average, share one year-round equivalent job. A year-round equivalent job is a statistical artifact--it is a shorthand way of saying that if one persons works 6 months on farms, another 4 months, and a third 2 months, one year-round job is created, even though all three of these seasonal workers might have been employed between June and September.

A seasonal industry such as agriculture will always have a "total workforce" that is larger than average employment; the issue is how large this reserve army of seasonal workers should be, and who should pay for the time of the workers who wait for work to begin. As best inadequate data can indicate, there has long been a 3 to 1 ratio between individual workers and average jobs in U.S. and California agriculture, and neither changes in the concentration of farm employment, mechanization, nor the increased demand for fruits and vegetables is likely to change these workforce and average employment numbers in the 1990s.

There are thousands of small farm employers, whose existence is most often noted in arguments over farm labor market rules. For example, in arguing that small farmers deserved easy access to immigrant workers, a Congressional representative implied that the norm in California was "the small farmer, with husband and wife, two or three children, who operate 30, 40, 50, or 90 acres, of which there are thousands in the San Joaquin Valley [who]... do not need the workers more than several weeks a year." (Rep Pashayan (R-CA), *Congressional Record*, June 14, 1984, p. H-5845).

However, farm employment patterns resemble farm production data. The average U.S.. farmer loses money every year, while the largest 14 percent of all farms produce over 80 percent of all farm products and earn over 100 percent of all farm profits because only large

farms, on average, make money farming. Similarly, the average farm employer employs only a few workers and pays only a few thousand dollars in wages, but such an average can be misleading because small farms and farm employers produce very little farm output and account for very little farm employment.

Mechanization

Most farm workers find jobs on the largest farms, and the decisions of these farms about whether to harvest crops by hand or machine determines the number and type of farm jobs available. Mechanization--picking a crop by machine rather than by hand--has reduced employment in many commodities over the past 25 years, but the production of other commodities has expanded enough to create new jobs and to stabilize farm employment. Processing tomatoes is the outstanding example of what happens to farm worker jobs as a result of mechanization. In 1960, a peak 45,000 worker--80 percent of whom were Braceros--hand-picked 2.5 million tons of the processing tomatoes used to make catsup. In 1990, about 5,500 mostly female farm workers were employed to sort 4 times more tomatoes.[69] In this case, mechanization reduced the number of jobs for farm workers, and changed the harvesting task from picking tomatoes into boxes to riding on a machine and sorting machine-picked tomatoes.

During the 1960s, the expectation that there would soon be no need those who could bring only strong backs to farm work was so widespread that the federal government began programs to help farm workers adjust to the nonfarm jobs they, it was expected, would soon have to seek. However, the mechanization of the tomato harvest proved to be the exceptional

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[69]It is very difficult to find consistent data on farm worker employment by commodity. A common approach is to ask farm advisors to estimate the hours of regular and seasonal labor required per acre to produce a commodity, but there are often unexplained differences between reports for the same commodity that is produced similarly in 2 counties. Mamer and Wilke (1990) report that the 40,000 acres of processing tomatoes in Yolo county required 6 regular and 38 temporary hours of labor per acre in 1989, while the 63,000 acres in Fresno county required 22 regular and 31 seasonal hours. These numbers were combined to generate a statewide average 16 regular and 34 seasonal hours per acre.

The major reason for the difference in hours is that in Yolo county, irrigation hours were reported to be 0, while in Fresno, they were 7 hours per acre. The Fresno report also included 5 hours of regular supervisory labor per acre, while the Yolo report had none.

Both county reports estimated that harvesting required 11 to 13 hours per acre, or that harvesting required fewer hours per acre than thinning and weeding (14 hours). At 12 hours per acre, sorting the tomatoes from 330,000 acres required 4 million hours of labor. Sorters sometimes work 12 hours per day and 6 day weeks; if they average 72 hours for 10 weeks, they average 720 hours. These calculations suggest that a total 5500 sorters would be required; at the usual wage hourly wage of $4.50 in 1993, sorters average $3240 each.

type of labor-displacing change in agriculture, not the rule. The surprise is how little labor-saving mechanization there was during the 1970s and 1980s, not how much.

There have been important labor savings in agriculture, but they are usually less visible than machines replacing hand harvesters. Changes in production practices for perennial crops have saved labor, such as drip irrigation (which saves irrigator labor), dwarf trees and vines trained for easier hand or mechanical pruning, and precision planting and improved herbicides that save thinning and hoeing labor.

There is also an important counter trend to displacing fieldworkers. In the past, most crops were picked by fieldworkers into bins or boxes and then hauled to a packingshed, where nonfarm workers sorted and graded the peaches and broccoli and put it into cartons. During the 1970s and 1980s, many crops began to be picked and packed in the field. Picking and packing grapes, vegetables, and melons in the field increases "farm" and decreases "nonfarm" employment.

Several factors encourage field packing: flexible conveyor belts and portable technologies make it easier to pick, pack, and cool cartons of produce in the fields, or get it quickly to a cooling facility; there is less damage to the commodity, because it is handled fewer times; and fieldworker wages are usually only half the levels of packingshed wages. Today, most table grapes and many melons and vegetables are sent directly from the field to the supermarket.

Field packing increases farm worker employment, but a more important reason why there are as many farm workers in the 1990s as there were in the 1960s despite mechanization and other labor-saving changes is because there is so much more fruit and vegetable production today. It is sometimes hard to appreciate how the expanded production of labor-intensive crops--reflected in both larger acreages and higher yields--creates additional jobs for farm workers.

Broccoli production provides an example. The average American's consumption of fresh vegetables rose 23 percent to 136 pounds per person during the 1980s, but the increase was sharpest for broccoli: the per capita consumption of fresh broccoli almost tripled from 1.6 to 4.5 pounds during the decade. Broccoli is hand-harvested, and its production in California

required an average 52 hours of hired labor per acre in 1990 (Mamer and Wilkie, 1990). There was a 50 percent or 40,000 acre increase in U.S.. broccoli acreage--most of it in California--during the 1980s, so 2.1 million additional hours of hired labor were needed to produce broccoli. Even though broccoli is harvested over a long-season, enabling workers to average 500 to 1,000 hours annually, the increased production of broccoli, a commodity worth just 1 percent of the total value of FVH commodities, required 2,000 to 4,000 additional seasonal workers just to handle the 1980s increase in production.

Americans are expected to continue to consume more fruits and vegetables, and the sharpest increases in consumption are expected for commodities that are eaten fresh, and thus are most likely to be hand harvested. The U.S. consumption of most farm commodities increases about 1 percent annually due to population growth, but the demand for FVH commodities increases another 2 or 3 percent annually, or about as much as personal incomes typically go up, because Americans tend to spend about the same percentage more on fresh fruits and vegetables as their incomes rise. For example, if the population increases by 1 percent and personal incomes rise 2 percent, then expenditures on fresh broccoli and strawberries also rise by 3 percent.

NAFTA

Americans can continue to increase their consumption of fresh fruits and vegetables that farm workers harvest without increasing farm worker employment if more fruits and vegetables are imported. Imported fruits and vegetables today account for less than 10 percent of the typical American's consumption, and most of these imports are fruits such as bananas that are not grown in the United States. Tomatoes, sometimes considered a symbol of the ability to produce a fresh vegetable far from where it will be consumed, are mostly produced in the United States—only 11 percent of the fresh tomatoes in 1992 were imported, mostly from Mexico during the winter months.

Will the North American Free Trade Agreement (NAFTA) shift the production of fruits and vegetables to Mexico? Perhaps after the year 2000, but not during the 1990s (Martin, 1993). Mexico's primary competitive advantage is climate; Mexico can produce fresh vegetables during the winter months when most U.S. production areas except Florida are not producing.

But even if Mexico were to completely displace production in Florida, most fruit and vegetable production would remain in the United States because two-thirds of the production occurs in the Summer and Fall, when Mexico is not producing significant quantities. Mexico is not even likely to replace Florida as the source of most winter fruits and vegetables because, in many cases, low yields and low labor productivity make production there more expensive than in Florida.

Mexican reforms and NAFTA are unlikely to spur a quick shift of production to Mexico. NAFTA would eliminate tariffs on fruits and vegetables grown in Mexico, but these tariffs are already low -- the average U.S.. tariff on the Mexican fruits and vegetables exported to the United States in 1990 was 8 percent, so that, as a result of NAFTA, the price of Mexican produce in the United States may fall by 8 percent. But these tariff reductions will be phased in over 15 years, and that may not be enough of an incentive to quickly expand fruit and vegetable production in Mexico. U.S. and some Mexican growers note that of many problems associated with producing in Mexico for the U.S.. market--higher transportation costs, less public research on disease and other factors which reduce yields, and lower worker productivity--will not be disappear quickly.

These Mexican disadvantages could be overcome with foreign investment and time, but Luis Tellez Kuenkler, Undersecretary in the Mexican Ministry of Agriculture and Water Resources, cautions that Mexico's fruit and vegetable agricultural exports will not skyrocket overnight, displacing U.S.. farm workers. He may be correct when he predicted in 1991 that Mexican FVH exports to the United States would rise, at most, by 40 percent within five years after a NAFTA is signed, or from $900 million in 1990 to $1.3 billion by 1998. U.S. FVH production by then is likely to be worth $35 to $40 billion annually, demonstrating that even increased imports from the country best suited to produce for the U.S. market is unlikely to eliminate the need for farm workers in U.S. agriculture.

.Farm Workers

.Immigrant Farm Workers

Immigrants from Mexico dominate the farm workforce. Farm labor data are notoriously unreliable, but the U.S. Department of Labor's National Agricultural Worker Survey (NAWS) found that the farm workforce throughout the United States is coming to resemble the stereotype long familiar in California, Texas, and Florida, viz., most farm workers are recent immigrants from Mexico (Mines et al, 1993).

The NAWS found that three-fourths of the workers employed on U.S. farms in the early 1990s are non-Hispanic whites. Most of these "minority workers" are immigrants from Mexico who have been in the United States for less than 10 years(Box 2). Many are Special Agricultural Workers (SAWs)—aliens who were illegally in the United States in the mid-1980s, and who were legalized under special provisions of IRCA. There is a significant and growing percentage of unauthorized workers--despite the legalization of 1.1 million farm workers in 1987-88. The best estimates of the percentage of unauthorized workers who harvest particular fruits and vegetables today range from 30 to 50 percent (Commission on Agricultural Workers, 1992), which translates into 10 to 30 percent of the entire hired farm workforce. These "new-new" immigrants include significant numbers of indigenous peoples from southern Mexico and Central America, such as non-Spanish speaking Mixtec Indians.

Most of the federal government's concern has centered on one subgroup of farmworkers: Migrant and Seasonal Farmworkers(MSFWs)--see Box 3. While employed, farm workers have average hourly earnings of about $5 . Most find work seasonally, so average weekly earnings of $180 to $200 for 26 weeks of work leaves the average farm worker with earnings that are only three-fourths of the poverty-level income for an individual ($6,300 in 1990).

The people who work on farms are diverse, and there has been a traditional interest in how many of them work seasonally (less than a full year) and migrate from one farm job to another. It is often believed that most farm workers are migrants who "follow the sun," moving from farm to farm to harvest crops. This is not the case (Martin and Martin, 1994). According

to the NAWS, the average farm worker in the early 1990s is employed on less than two farms during a typical year, and fewer than one in 8 follow the ripening crops from south to north.

The estimated number of migrant farm workers has been falling while FVH production continues to increase. A USDA study concluded that, based on production and other data, "migrants would logically have constituted an increasing, instead of declining, share of total hired labor...one explanation for this discrepancy is that foreign workers have accounted for an increasing share of migrant workers." (Oliveira, 1989, p. 5)

Indeed, the explanation for the apparent paradox of more labor-intensive crop production and fewer migrants lies in the fact that immigrants are a majority of all farm workers, and practically all of the new entrants. Some of these immigrant farm workers are not authorized to work in the United States, and their illegal status makes them hard to count in labor force surveys. Instead of the 350,000 illegal alien workers expected to request amnesty as farm workers under the Immigration Reform and Control Act (IRCA) of 1986, some 1.3 million aliens claimed to have done at least 90 days of farmwork in 1985-86. Many and perhaps most of these claims were fraudulent (Martin, 1990), but this legalization program made clear to all the predominance of immigrants in the farm workforce.

The dominance of immigrants affects the structure and functioning of the farm labor market, e.g. non-English-speaking immigrant workers often require intermediary bilingual FLCs or foremen to help them find housing and other social services; they are usually more willing to accept variation in days worked and piece rate earnings than U.S..-born workers; and immigrants are more likely to pay without question charges for housing, transportation, and eating arrangements in areas with farm jobs. Such behavior makes immigrants preferable to U.S. citizens in the eyes of most farm employers, and also hard to enumerate in Census of Population and labor force surveys.

Most immigrant farm workers do not remain farm workers for their working lives. Some farm workers do farmwork for only a few weeks or months, or even for a season, and then return to being a student or housewife, return to Mexico, or find a nonfarm job in the United States. In farm worker surveys based on interviewing a random sample of U.S. housing units, 40 percent of the estimated 2.5 million persons who worked for wages on the nation's

farms were considered to be primarily "not in the labor force" during 1985, and only 30 percent were considered to be primarily hired farm workers during the year (Olivera and Cox, 1988, p. 5). Such data were behind the assertion that the farm labor market offered workers an easy access opportunity to convert what would otherwise be unpaid time to work at low wages--the farm labor market was, seen in this view, as a "salvage" labor market (Fuller and Mason, 1977).

Unemployment Insurance

The NAWS, which interviews workers at work on farms rather than in the houses where they live, paints a different picture of the hired farm workforce. NAWS interviews with almost 5000 workers employed on farms in 1990 and 1991 found that only 12 percent could be considered casual workers who were using the farm labor market to convert what would other wise be unpaid into paid work time (Mines, Gabbard, and Samardick, 1993).

One NAWS analysis was based on a definition of a "temporary farm task" that considered one activity in one crop that lasts for up to six weeks to be a short-term farm job (Mines, Gabbard, and Samardick, 1993, p. 7). In the NAWS data, half of all hired workers had only farm jobs that lasted for six weeks or more, and these regular or long-task workers averaged 31 weeks of work on U.S. crop farms, 7 weeks of nonfarm work, and 4 weeks of unemployment each year(Table 3).

The half of the workforce that had at least one less-than-six-week job in 1990-91 was subdivided into the casual or temporary workers who might be seen as using the farm labor market as a salvage labor market for one or two less-than-six-week jobs, and periodic or seasonal workers, who had three or more "less-than-six-week" jobs (Mines, Gabbard, and Samardick, 1993, p. 8). According to NAWS data, periodic or seasonal workers fill most of the less-than-six-week jobs in U.S. agriculture--they are 3/4 of the workers who fill such short-term jobs, and they account for 90 percent of the time spent in such jobs.

NAWS data can indicate how workers spend their time, and what work-related and other government programs they participate in, but not the dollar amount of UI or other social program benefits to workers and their families. According to NAWS data, in 1990-91 the 88 percent of all crop workers who had at least one more-than-six-week job, or three-or-more "less-than-six-week" jobs, averaged 31 weeks of work on crop farms, including partial weeks of

work (Mines, Gabbard, and Samardick, 1993, p. 11). The periodic or seasonal workers who string together three or more farm jobs workers were unemployed for 7 weeks, or 13 percent of the year, while regular or long-task workers averaged 4 weeks of unemployment during which they sought farm jobs unsuccessfully.

One analysis based on NAWS data suggests that 63 percent of all crop workers were eligible for UI benefits, and that 43 percent applied for UI benefits (KRA, 1993). Since UI programs vary by state, and the NAWS did not collect data by state, it is not clear how KRA determined that almost 2 in 3 workers in the NAWS survey were eligible for UI benefits. The NAWS did not collect data on whether workers received UI benefits, so it provides no information on the value of UI benefits received and their percentage of worker earnings.

The Farm Labor Market

How do immigrant farm workers find jobs on the 800,000 U.S. farms that report hiring labor ? The farm labor market is like all others in the sense that it matches workers and jobs. However, it handles the three essential functions of a labor market in unique ways. First, farmers rarely come in direct contact with the workers they hire: information about the jobs is usually exchanged in Spanish, which most farm operators do not speak. Second, agriculture has dealt with the problem of training and motivating workers to work by paying piecerate wages--$10 per bin or oranges picked--for many jobs. Third, farmers assure themselves that there will be enough seasonal workers available by working collectively to maximize the supply of labor rather than trying individually to identify and keep the best workers on their farms.

Contractors or intermediaries such as foremen and crew bosses handle most of the recruitment of new workers (Box 4). Recruitment occurs in several ways. In some towns, such as those along the U.S.-Mexican border, there is a so-called day-haul labor market: workers begin to congregate at 3 or 4 am, and contractors arrive with buses, tell the workers the task and the wage, and the workers then board the bus that seems to offer the best job. Some workers board the same bus every day, while others switch from bus to bus.

The most common way in which farm workers are recruited occurs when the crew boss tells the crew that more workers are needed, and the workers currently in the crew inform their

friends and relatives that a job is available. Such "network recruiting" is very helpful to employers. There is no need to spend money on help wanted ads, and workers who are often grateful for jobs tend to bring to work only "good" workers. Once hired, the friend or relative who brought the new worker to the workplace is usually responsible for her: the experienced worker teaches the new hire how to work, the work rules, and other job-related information. In this decentralized hiring system, a worker may pay the crew boss to get a job, or the crew boss may allow a worker to bring his children to work.

Crew bosses are often more than just employers. Especially when the workers are recent immigrants, the boss may be the workers' banker, landlord, transportation service, restaurant, and check-cashing service. Crew bosses provide such services to workers to make money off them and because newly-arrive workers often need such services. Federal and state governments have enacted an ever-growing body of laws and regulations to that regulate these sideline activities of farm employers, but they have failed to change the reality that, in the farm labor market, immigrant farm workers often pay premium prices for inferior services. Regulations that require that farm worker housing be inspected, for example, have led to the destruction of housing on farms. Most workers today rent housing in nearby towns, and pay rent as well as $4 5o $5 daily for rides to work in the vans that have become the transportation system in rural California.

Day-haul and network recruitment best describes the decentralized hiring system most common in U.S. agriculture. There are other recruitment systems, but they are not common. A few large farms do all of their hiring from a central site, and require prospective workers to go to that site in order to fill out a job application.[70] Some of these farm employers hire workers in a nonfarm manner, with application forms, pre-employment medical and drug screening, and occasionally testing the skills of prospective workers and checking their references. However, very few workers are hired in such a manner. Fewer than 10,000 workers are sent to

[70]In one case, a Napa vineyard whose offices were adjacent to an award-winning restaurant had trouble recruiting workers despite higher-than-average wages. A farm labor consultant interviewed potential workers and informed the vineyard that it needed a hiring office away from the restaurant; farm workers felt uncomfortable having to go by it en route to the hiring office.

farm jobs annually by union hiring halls, and fewer than 50,000 are sent to fieldworker jobs by the public employment service--less than 3 percent of annual hires.

If the seasonal farm labor market were organized to minimize the number of workers needed, there would be one central clearing house to which farmers would go for workers and workers would report to for jobs. Reality is exactly the opposite: there is not even reliable data on the demand for and supply of workers, much less a central clearinghouse for jobs and workers. Decentralized hiring means that there are many farm labor markets. These markets may appear to be similar, in the sense that many of the jobs involving harvesting and most of the workers are Mexican immigrants, and the piecerate wages tend to be similar from field to field, but take-home pay nonetheless can vary from worker to worker.

Much of this variance in take home pay is linked to how a worker was recruited. Take-home pay is less if a worker must pay to get the job, if the worker needs or is required to accept housing and rides to work from the crew boss, or if the worker must pay for work equipment, check cashing, or many of the other services that some workers may need. Pay is also affected by hours of work; some crew bosses tend to overhire, so that each worker gets only 5 or 6 hours of work even on days when weather or marketing do not stop the work.

Once hired, workers must be motivated to work. There are two major wage systems used to pay seasonal farm workers. According to the NAWS, 70 percent of the jobs held by California farm workers in the early 1990s were paid hourly wages, and 30 percent were paid piecerate wages or a combination of hourly and piecerate wages (U.S. Department of Labor, 1993, p. 36-7). The most common hourly wage for entry-level workers is the minimum wage, which has been $4.25 hourly in California since July 1, 1988. Some employers pay more--$4.50 or even $5--in order to be able to select the best workers, but reports that hourly wages average, for example, $6.06, the figure reported for California fieldworkers by the USDA for mid-July 1993--can be misleading because such average wages are weighted by the hours that the various subgroups of hourly workers work. This means that the average hourly wage of e.g. a tractor driver paid $7 hourly for 10 hours of work daily, and two minimum wage hoers who each work 35 hours, are reported to have an average hourly wage of $5.62, even though neither the tractor driver nor the hoers are making a wage close to this average.

Piece rate wages are straightforward: workers are paid e.g. $12 per bin of oranges picked, or $0.16 per tray of raisins cut. A combination wage is often paid to harvest table grapes: a typical wage in 1993 was $5.25 per hour, plus $0.28 per 25 pound box of grapes packed.

The purpose of wage system is to motivate workers. Generally, employers pay hourly wages when they want slow and careful work, such as to prune trees and vines, when the employer can easily control the pace of the work, such as field-packing broccoli by walking behind a machine, or by tradition for certain tasks, such as early season picking and thinning and hoeing. Combination piecerate and hourly wages are paid when the employer wants careful but fast work: such as harvesting and packing table grapes in the field. Piece rates are paid in jobs in which it is difficult to regulate the pace of work, when quality is not of great importance, and when an employer wants to keep labor costs constant with a diverse work force.

The average hourly earnings of workers paid piecerates are typically higher than hourly wages, but this advantage tends to disappear when hours of work are considered. For example, according to the USDA, California farm workers who were paid hourly wages in July 1993 received about $6 hourly, while piecerate workers had average hourly earnings of almost $7. But hourly workers who average 40 hours per week have about the same weekly wage ($240) as piecerate workers who average 35 hours per week.

Recruitment gives U.S. agriculture a Mexican immigrant workforce, these workers are paid hourly or piecerate wages, and the third dimension of the farm labor market is retention--what do farm employers do to identify and persuade to return the best workers? The answer is not much.

Perhaps the easiest way to describe the attitude toward worker retention is by analogy to irrigation. Water is vital to produce crops in California, and there are two major ways to supply water to the crops. A field can be "flooded" with so much water that at least some trickles to each plant. At the other extreme, water pipes can be laid through the fields, and then only the water needed by each plant can be allowed to "drip" to each.

The choice of irrigation technique depends largely on the cost and availability of water. Where water is scarce and expensive, farmers tend to invest in drip irrigation systems; where water is cheap, farmers tend to flood their fields with water. The choice for farmers is to work collectively so that there is plenty of water for all, or to invest on a farm-by-farm basis to use scarce water as efficiently as possible. Farmers acknowledge that they consider labor in the same manner: should they work collectively to maximize the number of workers available, or treat labor as scarce and try to select and retain the fewest workers necessary?

Western farmers have usually chosen the flood-the-labor-marker alternative. The best source of additional water is to dam up rivers; the best way to get additional seasonal workers is by opening immigration doors, explaining why farmers have such a keen interest in immigration policy.

Part 3. Immigration Reform and U.S. Agriculture

Immigration Exceptions for Agriculture

U.S. agriculture provides a case study of how an industry can frustrate effective immigration control. There are many reasons why agriculture receives special treatment in immigration matters: it is considered a crown jewel of the U.S. economy; it is an old and dispersed industry with formidable political clout; and its need for unskilled seasonal workers has meshed neatly with the need of small farmers in Mexico for supplemental jobs. Politicians have embraced the contradictory goals of protecting the industry by making immigrant workers available, and then trying to help U.S. farm workers by speeding their movement into the nonfarm labor market. As a result, agriculture opens the most convenient door to the U.S. labor market for unskilled Mexican immigrants.

Special treatment for agriculture in immigration and labor matters is a leitmotiv of American history. Slavery in the southern colonies and states seemed necessary to the farmers of the time to keep a seasonal farm work force available to fill seasonal jobs on cotton and tobacco plantations when free land was available to non-slave farm workers in the west. When irrigation and the transcontinental railroad made it profitable to grow labor-intensive fruit crops for eastern U.S. markets in the 1870s, California farmers looked for "un-American" supply of labor. The leading farm magazine of the time asked "where shall the laborers be found?...to become the working men "on the state's farms? Farm work was described as " the work of the slave," and the magazine repeated its question and offered a solution: "Then where shall the laborers be found? The Chinese! ...those great walls of China are to be broken down and that population are to be to California what the African has been to the South."[71]

Immigration policy and immigrants are linked to fruit and vegetable agriculture because immigrants constitute almost two-thirds of the industry's current work force and nearly all of

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[71]The California Farmer in 1854, quoted in Varden Fuller, Hired Hands in California's Farm Fields (Berkeley: Giannini Foundation, 1991, p. 7). A California farm spokesman in 1872 observed that hiring seasonal Chinese workers who housed themselves and then "melted away" when they were not needed made them "more efficient . . . than negro labor in the South [because] it [Chinese labor] is only employed when actually needed, and is, therefore, less expensive" than slavery." Quoted in Fuller, *The Supply of Agricultural Labor as a Factor in the Evolution of Farm Organization in California*, in U.S. Senate Committee on Education and Labor (LaFollette Committee), Part 54 (Washington: U.S. Senate, 1940), p. 19809.

the new entrants to the seasonal fruit and vegetable workforce.[72] Among the 140 million Americans who have paid employment sometime during a typical year, only two percent do farm work, and many of these farm workers are teenage hired hands on midwestern family farms. But of the almost six million immigrant workers who were in the United States legally by the end of the 1980s, up to 1.5 million or 25 percent did at least some farm work, reflecting the enormous appetite of seasonal farm factories for new workers.[73] If 1980s immigration patterns continue in the 1990s, up to 1/4 of the working-aged U.S. immigrants who arrive during the decade may be Mexicans whose initial U.S. employment is in fruit and vegetable agriculture.

Immigration Reform

When the Congressional hearings that eventually culminated in IRCA began in 1981, the positions of farm worker and farmer advocates were not well developed. United Farm Workers (UFW) representative Stephanie Bower, for example, testified on September 30, 1981, that the UFW supported "imposing sanctions on employers who hire illegal aliens...[but since] laws covering farm workers have been rarely enforced...we strongly urge that a large budget for staff and operations be allocated to enforce sanctions.[74] The UFW also supported issuing counterfeit-proof social security cards to all workers , including farm workers, to verify their legal right to work in the United States.

The National Council of Agricultural Employers (NCAE) testified that it had not yet developed a position on employer sanctions, but that if there were to be a sanctions law, "we [agriculture] must have some means to offset a worker shortfall if there are not enough U.S. workers to fill the needs of agricultural employers." (Ibid., p 125). The NCAE offered two

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[72]Farm worker data are notoriously unreliable. Seasonal fruit and vegetable agriculture appear to employ between one and two million workers annually, and almost all of the 200,000 to 300,000 new workforce entrants each year are immigrants. There are some U.S. citizen children of immigrant farm workers who also enter the farm work force, but most are farm workers only as teenagers.

[73]About 600,000 legal immigrants entered the United States annually during the 1980s, and 50 percent or 300,000 joined the labor force, including about five percent (150,000 of three million) with farming occupations The Effects of Immigrants on the U.S. Economy and Labor Market (U.S. Dept. of Labor, ILAB, 1989), pp. 25 and 27. About 80 percent of the 1.8 million general legalization applicants were in the labor force (1.44 million), including 80,000 farm workers (5 percent). All of the 1.3 million SAW applicants should have done farm work in the mid-1980s. The INS indicated in March 1991 that it would approve only 910,000 or 71 percent of these SAW applications.

[74]Senate Serial J-97-61, 1981, p. 78.

reasons why sanctions might lead to farm labor shortages: "they [illegal alien farm workers] will move to other jobs where they may get 12 months out of the year employment"...and many of "those people" (illegal aliens) "do not want amnesty," so if they must "choose amnesty" in order to work in the United States, "they may just opt [to go] back to Mexico."[75]

When the Simpson-Mazzoli immigration reform bill was introduced in 1982, it included sanctions on U.S. employers who knowingly hired illegal aliens, an amnesty for aliens in the United States illegally since 1978, and a streamlined H-2 program that allowed temporary farm workers to fill temporary U.S. jobs if American workers were unavailable at government-set wage and working conditions. Western farm employers were not satisfied with the prospect of a government certification process standing between them and the Mexican workers to whom they had become accustomed. They argued that they could not plan their need for seasonal labor because they produced perishable commodities, that they lacked the free housing which required to obtain H-2 workers, and that unions might urge the government not to approve their requests for alien workers on the grounds that U.S. workers were available.

In January, 1983, representatives of most U.S. farm employers met in Dallas, Texas, to decide whether to press for further changes in the H-2 program to accommodate Western growers or to seek a new foreign worker program. The decision was made to seek a new foreign worker program. The Farm Labor Alliance (FLA), a coalition of about 22 farm organizations, was created to press for such a program in Congress.[76] The FLA decided to work through Tony Coehlo (D-CA), then the "number 3" person in the Democratic hierarchy of the House of Representatives.

The FLA wanted a flexible guestworker program under which legal non-immigrant workers would be confined while in the United States to farm jobs, and U.S. farmers would not be required to go through a certification process to employ them. Both Senator Simpson and Representative Mazzoli opposed such a free agent guestworker program, arguing that such a program was hard to justify in legislation designed to re-assert control over immigration. Free

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[75]Senate Serial J-97-61, 1981, p. 125.

[76]The FLA included farm 22 organizations, from the CA Grape and Tree Fruit League to the Washington Asparagus Growers. Many farm employers on whose behalf the FLA lobbied belonged to 2 or more of the organizations that in turn comprised the FLA (FLA Grower Bulletin, 1986).

agent guestworkers, they argued, would be difficult to regulate in a manner which would not undermine the wages and working conditions of U.S. farm workers.

Representatives Panetta (D-CA) and Morrison (R-WA) introduced the FLA's P-visa guestworker program as an amendment to the Simpson-Mazzoli bill in the House in 1984. To the surprise of many observers, the House approved the Panetta-Morrison guestworker program in June 1984, producing what the New York Times described as one of the year's top 10 political stories. In the Senate, Simpson tried to appease the FLA with a streamlined H-2 program for agriculture, a three-year transition program under which farmers (and only farmers) could use 100, 66, and 33 percent of their base year's employment of illegal aliens, and a Commission on Agricultural Workers (CAW) to study farm labor issues further. However, the FLA got Senator Wilson (R-CA) to offer another version of the Panetta-Morrison program in 1985 as an amendment to the immigration reform bill and, after Wilson agreed to cap the number of guestworkers at 350,000, the amendment passed.

When the House considered immigration reform in 1986, Representative Rodino (D-NJ) asserted that he would try to block legislation that included a Panetta-Morrison or Wilson-type guestworker program for agriculture: "I cannot--and will not--support a bill with a guestworker component...I would rather not see a bill than one which would jeopardize the wages and working conditions of American farm workers." (quoted in Congressional Quarterly, Vol. 44, NO 25, June 21, 1986, p. 1411). During the summer of 1986, Representative Schumer (D-NY) negotiated a compromise legalization program with Representative Panetta (D-CA), representing employer interests, and Representative Berman (D-CA) representing worker interests, and this "Schumer compromise" was a key element in permitting the Immigration Reform and Control Act (IRCA) of 1986 to be enacted.

IRCA created the Special Agricultural Worker (SAW) and Replenishment Agricultural Worker (RAW) programs: SAW to legalize and stabilize the current illegal alien work force, and RAW to admit probationary immigrant farm workers if newly-legalized SAWs quit doing farm work and their exit led to farm labor shortages. Worker advocates agreed to this SAW-RAW compromise because the SAWs were free to leave agriculture; these advocates were concerned primarily about H-2-type workers who were dependent on their U.S. farm

employers to stay employed in the United States. SAWs, they reasoned, would have the power to say no to unfair wages and working conditions and, after illegal immigration stopped, the power to negotiate higher farm wages. Farmers won assurances that the relatively easy requirement for SAW legalization would permit them to continue to employ their current workers, and then RAWs could enter the United States if labor shortages developed.

IRCA's Agricultural Provisions

IRCA included three major agricultural provisions: deferred sanctions enforcement and search warrants, the SAW legalization program, and the H-2A and the RAW foreign worker programs. Each provision had anticipated and unanticipated consequences.

IRCA also made significant changes in agricultural enforcement practices. Before IRCA, the Immigration and Naturalization Service (INS) enforced immigration laws in agriculture by having the Border Patrol drive into fields and apprehend aliens who tried to run away. Farmers pointed out that the INS was required to obtain search warrants before inspecting factories for illegal aliens, and they argued that the INS should similarly be obliged to show evidence that illegal aliens were employed on a farm before raiding it. IRCA extended the requirement that the INS have a search warrant before raiding a workplace for illegal aliens from nonfarm to agricultural workplaces.

This search warrant provision was won by the farmers' argument that farms should be treated like factory workplaces. The similarity stopped there: farmers argued that farms, unlike factories, were extraordinarily dependent on unauthorized aliens, and that sanctions should not be enforced while the legalization program for farm workers was underway. Sanctions enforcement was thus deferred in most crop agriculture until December 1, 1988.

IRCA created two legalization programs: a general (I-687) program which granted legal status to illegal aliens if they had continuously resided in the United States since 1982, and the SAW farm worker (I-700) program, which granted legal status to illegal aliens who did at least 90 days of farm work in 1985-86. Because farmers and farm worker advocates testified that many illegal alien workers were paid in cash, it was much easier for illegal alien farm workers

to satisfy this work requirement than it was for nonfarm aliens to satisfy the residence requirement.[77]

No one knew how many illegal aliens were employed in U.S. agriculture in the mid-1980s. Most farmers and farm worker advocates accepted a USDA estimate that there were 350,000 illegal aliens were employed in agriculture, and this number became the maximum number of Group 1 SAWs.[78] However, the major surprise of the SAW program was that 1.3 million aliens applied for SAW status, or almost three-fourths as many as applied for the general legalization program, even though it was widely asserted that only 15 to 20 percent of the undocumented workers in the United States in the mid-1980s were employed in agriculture.

SAW applicants turned out to be mostly young Mexican men (Table 4). Their median age was 24, and half were between 20 and 29. Since SAWs had to be employed in 1985-86 to qualify, there were few SAWs under 15, compared to 7 percent of the general legalization applicants. Over 80 percent of all SAW applicants were male, and 42 percent were married. In a few limited surveys, SAWs who had an average 5 years of education earned between $30 and $35 daily for 100 days of farm work in 1985-86.

The INS by early 1992 had adjudicated 93 percent of the SAW applications. The INS approved 88 percent of the applications on which it has completed its work, or just over 1 million illegal aliens have become immigrants through the SAW program. There may be additional SAWs approved, but the INS has recommended that many of the remaining 235,000 applications for legal status be denied.

Some SAWs did leave agriculture, but the major reason that so few SAWs are reported to be still working in agriculture is because many of the people who applied and were legalized under IRCA's provisions for agricultural workers were not farm workers at all. Employer-

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[77]A SAW applicant, for example, could have entered the United States illegally in early 1986, left after doing 90 days of farm work, and then applied for SAW status from abroad. An applicant was permitted to apply for the SAW program with only an affidavit from an employer asserting that the worker named in the letter had done e.g. 90 days of work in virtually any crop. The burden of proof then shifted to the INS to disprove the alien's claimed employment.

[78]Group I SAWs did at least 90 days of SAS work in each of the years ending in May 1, 1984, 1985, and 1986. Group II SAWs, by contrast, did 90 days of SAS work only in the year ending May 1, 1986. Over 90 percent of all SAW applicants were in the Group II category.

generated data in California, for example, suggest that there should have been fewer than 200,000 legitimate SAW applications in the state, but 700,000 were submitted.[79] Surveys report that legitimate SAWs and other farm workers are not leaving the farm work force: a national survey of farm workers found that over 90 percent of the persons doing farm work when interviewed in 1989 were still doing farm work in 1990, largely because lack of English, skills, and contacts kept them in the farm work force.

If two-thirds of the mid-1980s unauthorized farm workers had really left agriculture, frequent complaints of farm labor shortages might be expected.[80] But there have been far more reports of farm labor surpluses than shortages. Ample supplies of labor encouraged expansion: if there were profits to be made by expanding fruit and vegetable production, U.S. growers expanded; IRCA did not signal U.S. growers that in the future immigrant harvest labor would be scarce or more expensive.

Before IRCA, illegal alien farm workers were often called undocumented workers because they did not have documents which authorized them to work in the United States. IRCA changed many of these undocumented workers into documented SAWs, and those who continue to arrive in the United States into "documented illegal aliens." Today's "documented illegals" have the work authorization documents (usually an I-551 green card and a driver's license) needed to be employed legally in the United States, although these documents are generally purchased at weekend flea markets for $30 to $50, not issued by the U.S. government.

Neither the RAW nor the H-2A program has admitted any additional legal foreign workers since IRCA. RAW program admissions depend on national calculations of farm labor "need" and supply made by the Secretaries of Labor and Agriculture,[81] while H-2A admissions require employers to initiate a request for alien workers. RAW labor shortage calculations indicated that no RAW visas should be issued in FY 1990, 91, 92, and 93, i.e., national

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[79]Philip Martin, Edward Taylor and Philip Hardiman, "California Farm Workers and the SAW Legalization Program," California Agriculture 42:6, 4-6 (November-December 1988).

[80]There were newspaper reports of labor shortages and rising wages in the wake of IRCA, but they turned out to be isolated exceptions. For example, a September 5, 1989 story in the Wall Street Journal noted that growers complained of too few strawberry pickers in California and too few cucumber pickers in North Carolina, and a USDA representative attributed instances of wage increases to "a great deal of competition out there for labor" (page 1).

[81]These calculations are described in Philip Martin, "The Outlook for Agricultural Labor in the 1990s," UC Davis Law Review, 23:3, 499-523 (Spring 1990).

calculations of farm labor needs and farm worker availability did not produce the necessary prediction of a labor shortage to justify the issuance of RAW visas, and the RAW program expired on September 30, 1993. The H-2A program has shrunk since IRCA.

IRCA's Effects

The effects of the SAW-RAW compromise on U.S. farmers and farm workers were not debated extensively in Congress, although the possible effects of other immigration reforms on agriculture had been discussed throughout the early 1980s. It is possible to discern a range of expected IRCA effects on farmers and farm workers, but most suggest that IRCA should have had at least two effects in agriculture: farm workers should be legal U.S. workers, and farmers should have raised wages somewhat and improved employment practices in order to retain newly-legalized SAW workers.

IRCA has not had these hoped-for effects in agriculture. There are several reasons, including a continued influx of unauthorized workers, and less rather than more effective enforcement of immigration and labor laws in agriculture.

One of the most dramatic changes in the farm labor market due to IRCA is the switch from undocumented workers to falsely documented workers. Illegal immigrants who do farm work are usually among the poorest and least sophisticated such workers in the United States. IRCA may well be remembered as a stimulus to illegal immigration for spreading work authorization documents and knowledge about them to very poor and unsophisticated rural Mexicans and Central Americans, encouraging first-time entrants from these areas.

In the early 1990s, pre-IRCA legal farm workers, newly-legalized SAWs, and a continued influx of illegal aliens have produced an ample supply of seasonal workers, giving farmers little incentive to improve wages and working conditions. Study after study confirms the fact that most farmers have not raised wages, improved working conditions or housing, or otherwise made adjustments to recruit and retain legal workers. Instead, the IRCA-wrought influx of workers has encouraged in some cases reductions in wages and farm worker earnings.[82]

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[82]These studies are summarized in the Final Report of the Commission on Agricultural Workers (Washington: Government Printing Office, 1992).

Most farm workers have been paid the same per hour worked or unit of work done since the late 1980s, but farm worker earnings have nonetheless declined in many instances because, with more workers, each does fewer hours of work. Farm worker profiles indicate that a typical seasonal worker is available for farm work about 40 weeks per year, finds work during 20 to 25 weeks, or 700 to 1,000 hours, so that, at $5 hourly, farm work generates $3,500 to $5,000 annually.[83]

Seasonal farm workers have also been affected by the post-IRCA tendency of farm operators to hire more seasonal workers through FLCs. In California, the "market share" of FLCs appears to have risen from about 1/3 of all job matches in the early 1980s to over half in the early 1990s. Employees of FLCs are worse off in several ways, including the tendency of FLCs to pay lower wages to recently arrived immigrants. Many FLCs condition employment on worker acceptance of housing away from the worksite, and then they charge workers for both housing and rides to work. Housing away from the farm, usually in barracks-style accommodations, costs each worker $25 to $35 weekly, and then the private rural taxis which provide rides to worksites typically charge each worker $3 to $5 daily. A worker getting $200 weekly (40 hours @ $5), often has $50 or 25 percent less take-home pay if he or she is employed by a FLC because of these housing and taxi charges.

Hiring documented illegal workers through FLCs means that few farmers have planned for a future of fewer and better-paid legal workers. Unlike the U.S. manufacturing industries that shrank in the face of lower-wage competition during the 1980s, labor-intensive U.S. agriculture expanded, usually in ways that guarantee farm labor shortages in the 1990s. In state after state, the story is similar: Washington apple acreage up 25 percent since IRCA; 3,000 acres of citrus planted in remote areas of California since the mid-1980s; thousand acre blocks of oranges planted in Southern Florida. When asked about the labor assumptions that went into these plantings, many of which will not need harvest workers until the mid-1990s, the

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[83]The DOL National Agricultural Worker Survey (NAWS), which probably includes a disproportionate share of the long-season and year-round workers who do most of the days of farmwork done by hired workers, reports that median earnings in 1989 were $7,500 for 37 weeks of work. These SAS workers were young (median age 30), male (3/4) foreign-born (3/4), and poorly educated (median six years of education; 3/4 cannot read English well). SAWs are about 40 of the NAWS sample, and post-IRCA "documented illegals" are about 10 percent. Findings From the NAWS: A Demographic and Employment Profile of Perishable Crop Farm Workers. (Washington: U.S. Department of Labor, July 1991).

answers are a sheepish we-didn't-think-about-labor or we assumed seasonal labor would be available at the minimum wage, "as it always has been."

Reform Recommendations

There was a great deal of uncertainty about IRCA's effects on farmers and farm workers. This uncertainty, as well as the 4-year life of the RAW program, gave the IRCA-createdCommission on Agricultural Workers (CAW) its mandate to review the effects of IRCA and especially its SAW provisions on the farm labor market.

The Commission was charged with "reviewing" nine questions and conducting "an overall evaluation of the special agricultural provisions" of IRCA. On the basis of case study research and hearings, the Commission made three types of findings. First, in its overall evaluation of the SAW program, the Commission concluded that the majority of SAW-eligible undocumented workers gained legal status, but through such a flawed worker- and industry-specific legalization program that Robert Suro in the New York Times described the SAW program as " one of the most extensive immigration frauds ever perpetrated against the U.S. government."[84]

Second, the Commission found that, although the SAW program legalized many undocumented farm workers, the continued influx of illegal workers prevented newly legalized SAWs from obtaining improvements in wages and benefits from farmers. Third, the Commission reported that the farm labor market continues to leave the average farm worker with below-poverty level earnings.

The Commission recommended that federal and state governments should take steps to develop a legal farm work force, to improve social services for farm workers and their families, and to improve the enforcement of labor laws. In response to IRCA's failure to reduce illegal immigration, the Commission recommended more enforcement and a fraud-proof work authorization card. To combat declining real wages, the absence of benefits like health insurance, and the exclusion of some farm workers from federal and state programs that would make them eligible for unemployment insurance benefits and workers compensation, the

[84]Reprinted in the Sacramento Bee, November 12, 1989, p. A1.

Commission recommended that the federal government provide more services to farm workers and their children and that farm workers be covered under protective labor laws. Finally, the Commission recognized that federal and state agencies today have only a limited ability to enforce farm labor laws, and recommended that enforcement efforts should be better coordinated and targeted.

The Commission also made several recommendations that may undermine some of these efforts to reduce farm worker poverty. For example, the Commission recommended that the same regulations govern the importation of non-immigrant farm and nonfarm workers. This recommendation was made in the spirit of ending agricultural exceptionalism, the practice of exempting farmers from labor laws under the theory that family farmers should not be burdened by excessive formal regulation. However, the employer certification and worker protections in the agricultural H-2A program are there because of past problems. While the Commission developed no evidence that the nonfarm H-2B program needs these extra procedures and protections, it heard considerable testimony that current protections in the H-2A program are inadequate. Thus, the intent of this recommendation can only be to substitute weaker H-2B procedures for stronger H-2A rules, and this flies in the face of the evidence that was developed. The H-2A program may need to be reviewed, but probably not with the goal of substituting H-B2 criteria for H-2A criteria.

The Unfinished Agenda

Most of the Commission's consensus recommendations seem to be a useful step in the right direction, but they fail to deal with the root causes of the farm labor problem and the legacies of IRCA's agricultural provisions. The federal government has permitted immigration to be a subsidy for the labor-intensive fruit and vegetable subsector of U.S. agriculture. This immigrant labor subsidy, in turn, encourages the expansion of an industry in which the majority of workers earn below poverty-level incomes. This farm worker poverty is widely recognized, but there is unlikely to be an effective solution to reduce it until the question of who is responsible for the farm worker's plight is confronted.

It is often argued that poor farm workers are the price that must be paid for cheap food. But the relationship between cheap farm workers and cheap food has not been studied. The

numbers seem to belie this conventional wisdom. Two-thirds of the nation's farm work is done by farmers and their families. Hired workers do only one-third of the nation's farm work. Immigrant farm workers, the poorest hired workers, do about two-thirds of the work done by hired workers. This means that, if there were no immigrant farm workers, almost 80 percent of the nation's farm work would be done without them. In other words, holding down the wages of seasonal farm workers, while it impoverishes more than 1 million American workers, holds down the average family's food bill only a little. Even in the case of the fruits and vegetables that immigrant workers harvest, farm wages typically account for less than 10 percent of the retail price of a head of lettuce or a pound of apples. Doubling farm wages, and thus practically eliminating farm worker poverty, would raise retail food prices by less than 10 percent.

Retail food prices may not even increase if the U.S. government aimed to increase rather than depress farm wages. The farmers who relied on Mexican Bracero workers in the early 1960s argued that "the use of braceros is absolutely essential to the survival of the tomato industry."[85] What happened when they nonetheless disappeared? The termination of the bracero program in 1964 accelerated the mechanization of the harvest in a manner that quadrupled production to 10 million tons between 1960 and 1990. Cheaper tomatoes permitted the price of ketchup and similar products to drop, helping to fuel the expansion of the fast food industry.

Not only is it inefficient to hold down food prices by holding down farm worker wages; it is also morally wrong. Why should immigration exceptions hold down the wages of farm workers, who average $5000 annually, in order to lower food prices for nonfarm workers, whose average earnings are $25,000 per year? The federal government should collect data and conduct studies on the true costs of cheap farm workers. These costs are significant, and as the farm work force includes more and poorer immigrants, the cost will rise.

Second, the government will have to deal with the new dynamic element that is gradually reducing it's ability to regulate the farm labor market: farm labor contractors (FLCs).

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[85]California Senate, Senate Fact Finding Committee on Labor and Welfare, California's Farm Labor Problems: Part 1, 1961, p. 105.

FLCs are the intermediaries who, for a fee, recruit, transport, and supervise farm workers. Since IRCA was enacted in 1986, the share of all seasonal job matches made by FLCs has increased. Today it exceeds 50 percent in many harvest labor markets. Worker, farmer, and agency testimony as well as research suggest that FLCs are practically a proxy for the employment of undocumented workers and egregious or subtle violations of labor laws.

Given ineffective immigration controls and insufficient farmer-provided and public services, such as housing for newly-arrived immigrants, FLCs have privatized important parts of both immigration policy and immigrant services. As they play the role of 19th Century ship captains in recruiting, transporting, and employing new arrivals, their activities promise to bring into rural communities some of the neediest immigrants – relative to the average American – that have ever arrived in the United States.

The increase in FLC activities has been driven by several factors, including farmer efforts to minimize enforcement risk, the arrival of more diverse immigrant workers, and the legalization of people with the requisite experience to get into the game. IRCA's employer sanctions increased the potential cost of hiring illegal alien workers, so growers rationally tried to shift these risks to FLCs, since they, under IRCA, are employers in their own right. Second, the "new-new" immigrants arriving since IRCA have in many cases needed non-traditional intermediaries for language, recruitment, or social service reasons – farmers used to dealing with Mexicans from the Central Highlands were not necessarily capable of dealing with the Mixtecs and Guatemalan Indians arriving today. Third, the SAW program legalized more persons who could be FLCs; FLC registration usually requires legal status, and some newly-legalized SAWs became FLCs.

FLCs, immigrants, and labor standards seem to be mutually incompatible. A contractor operates between a farmer and a farm worker, but the power of the two over the contractor is very different. Farmers typically know what the going overhead or commission is, and thus FLCs are unlikely to extract an extra-high fee from them. Newly-arrived immigrants, on the other hand, may not know the minimum wage, so that FLCs can turn what appears to be a money-losing deal with farmers into a profit-making deal by extracting money from workers. As the U.S. Industrial Commission observed in 1901, "the position of the contractor...is

peculiarly that of an organizer and employer of immigrants...He holds his own mainly because of his ability to get cheap labor...(he) succeeds because he lives among the poorest class of people, knows them personally, knows their circumstances, and can drive the hardest kind of bargain with them."[86] The United States may have to follow the German practice and prohibit labor contracting in industries in which contracting has proven difficult to regulate.

Third, IRCA's most important legacy may be the foundation it laid for a new wave of rural poverty in the United States. The rural poverty that many thought was reduced when millions of small white and Black farmers left agriculture in the 1950s and 1960s may be recreated through immigration in the 1990s.

The SAW program legalized mostly young Mexican men who were working illegally in U.S. agriculture. By legalizing only these working men, some hoped that they would be encouraged to continue to return to their families each winter. Many continue to commute between the United States and Mexico, but many others are bringing their families to the United States. These mixed families – mixed in terms of the legal status of family members – need education, health, and social services if they and their children are to succeed in the United States. However, their settlement in rural America and their mixed legal status makes it difficult to provide them with the social services that they need.

Conclusions

The H-2A program is an immigration and labor market anomaly. It is an immigration anomaly because only this program exempts from FUTA and FICA taxes the earnings of legal nonimmigrant workers. It is a labor market anomaly because it is the only temporary worker program under which DOL invests significant resources to determine in foreign workers are needed, and to investigate whether U.S. farm employers are adhering to program regulations.

The first issue addressed in this report was the effect of not extending the repeal of the FUTA exemption after its scheduled exemption on January 1, 1995. Other U.S. employers of legal nonimmigrant workers pay federal and state UI taxes on their earnings and, with H-2A workers declining to just 10 percent of the 160,000-odd annual admissions of such workers, the

[86]Reports, U.S. Industrial Commission (Washington: Government Printing Office, 1901) Volume XV, Part III, p. 320-21.

H-2A seems to be an outdated break for a small group of employers--2/3 of the estimated $5 million savings from the FUTA exemption, for example, accrues to farm employers in FL, NC, and VA.

This report then raised two other issues. First, should small farm employers continue to be exempt from providing UI coverage for their employees? Virtually all commissions that have examined the small farm exemption concluded that it should be eliminated. But if UI coverage is extended to more farm workers, another issues is raised--what should be done if 10 to 30 percent of all farm workers are unauthorized workers, and if states crack down on the unlawful receipt of UI benefits by such workers. This report provides background information needed to consider the role of hired farm workers in U.S. agriculture and to assess the effects of eliminating the rule that denies UI benefits to unauthorized workers.

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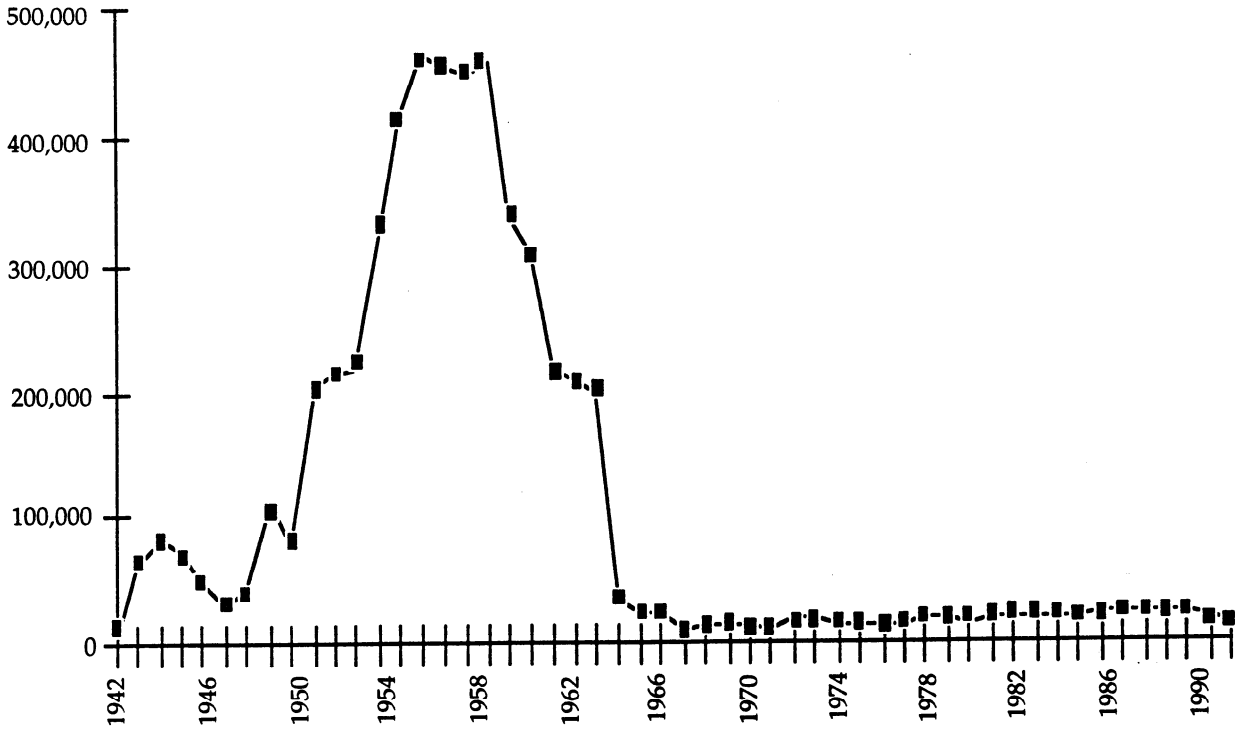
Figure 1. DOL H-2A Certifications 1943-93



Data before 1965 include only British West Indian workers; post 1965 data include H-2 or H-2A farm workers from all nations.

Source: DOL

Figure 2. Mexican Braceros, Apprehensions, and Immigration: 1942-1964

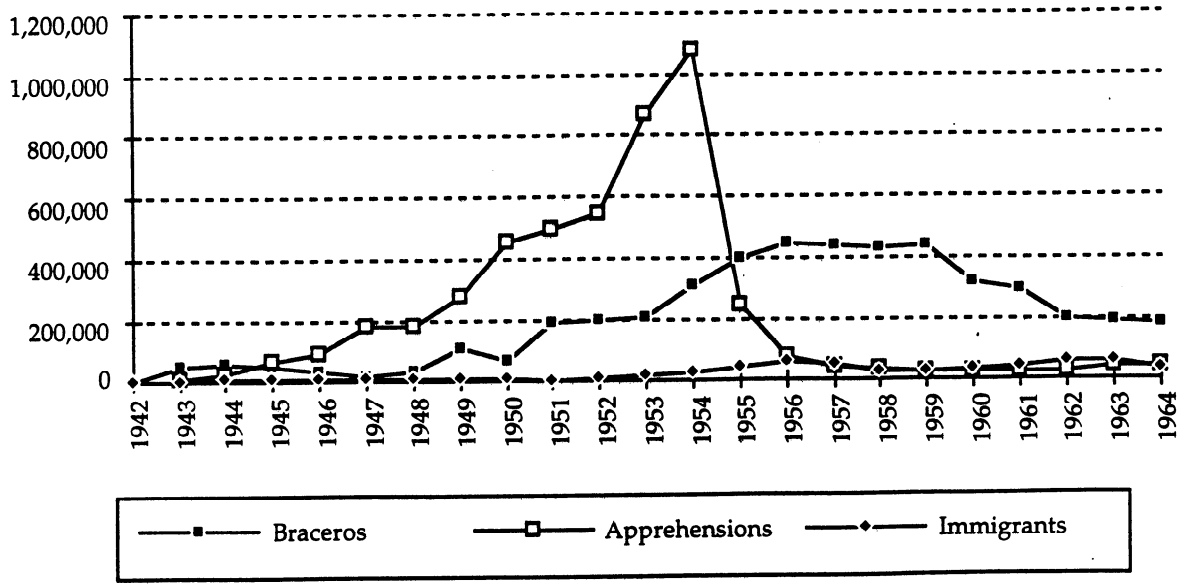
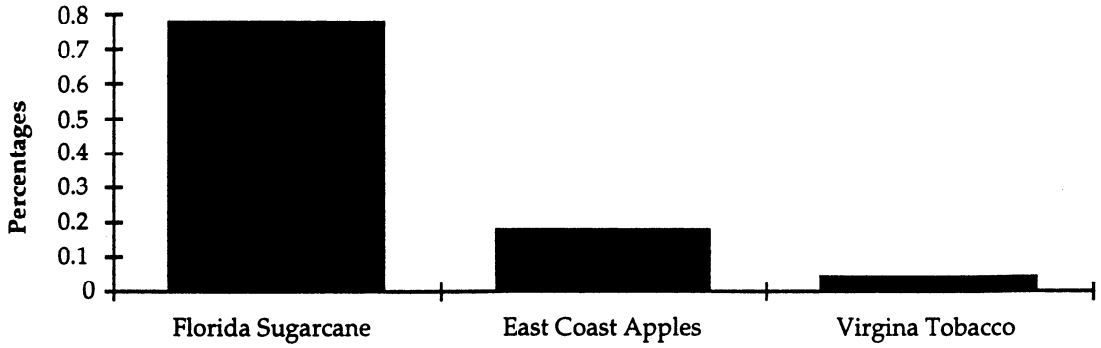
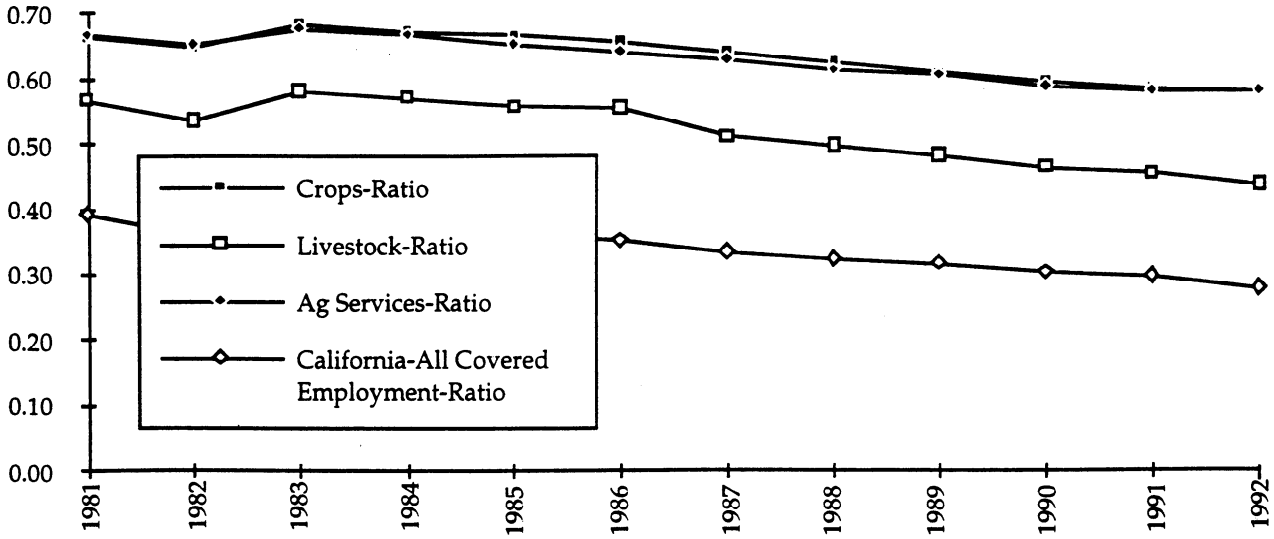


Figure 3. Distribution of FUTA and FICA Tax Savings: 1980.



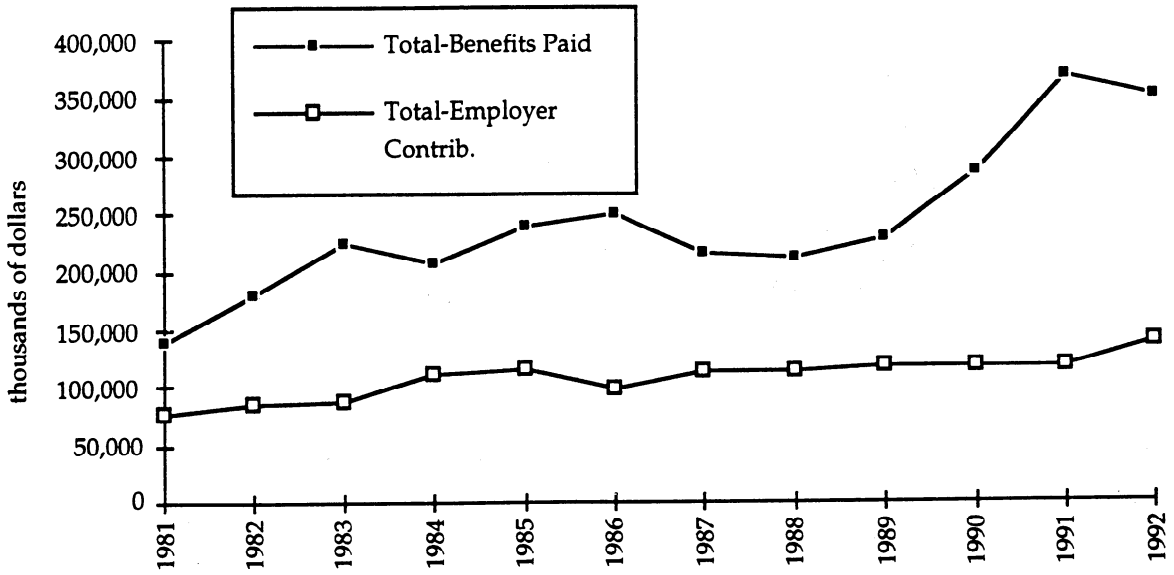
Sources: U.S. Department of Labor, U.S. Employment Service, and the Social Security Administration, as calculated by Pollack, et. al. 1982. Estimated FICA and FUTA savings were $2.5 million.

Figure 4. Ratio of UI Taxable to Total Wages Paid: 1981-1992



Source: California Employment Development Department, Report 352, Various Years

Figure 5. UI Benefits Paid and Employer Contributions in California Agriculture: 1981-1992



Source: California Employment Development Department, Report 352, Various Years

Figure 6. Ratio of UI Benefits Paid to Employer Contributions in California Agriculture: 1981-1992

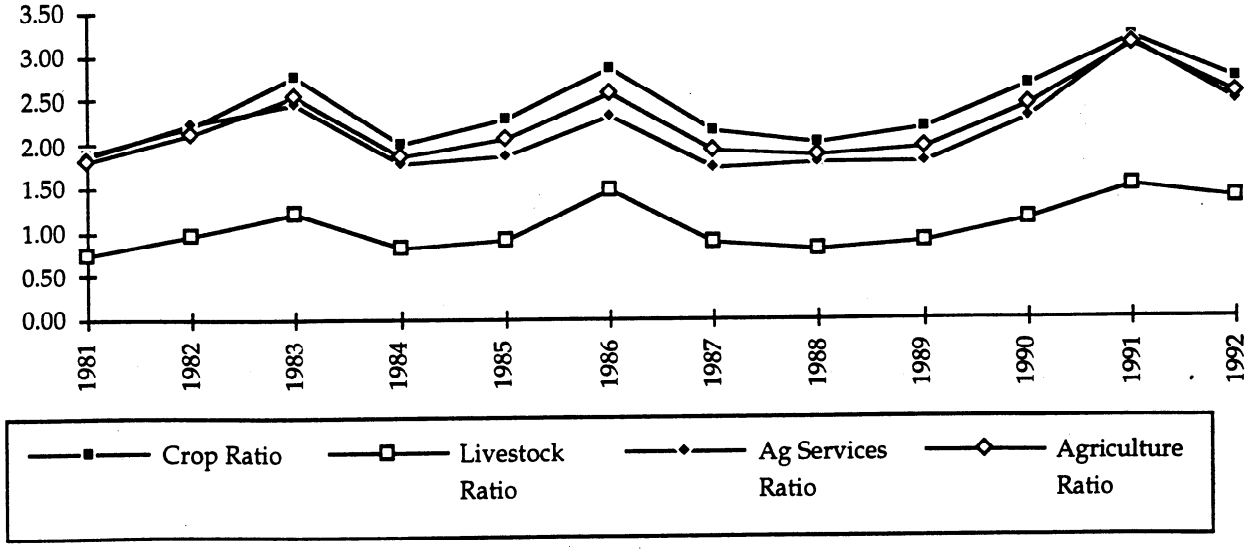
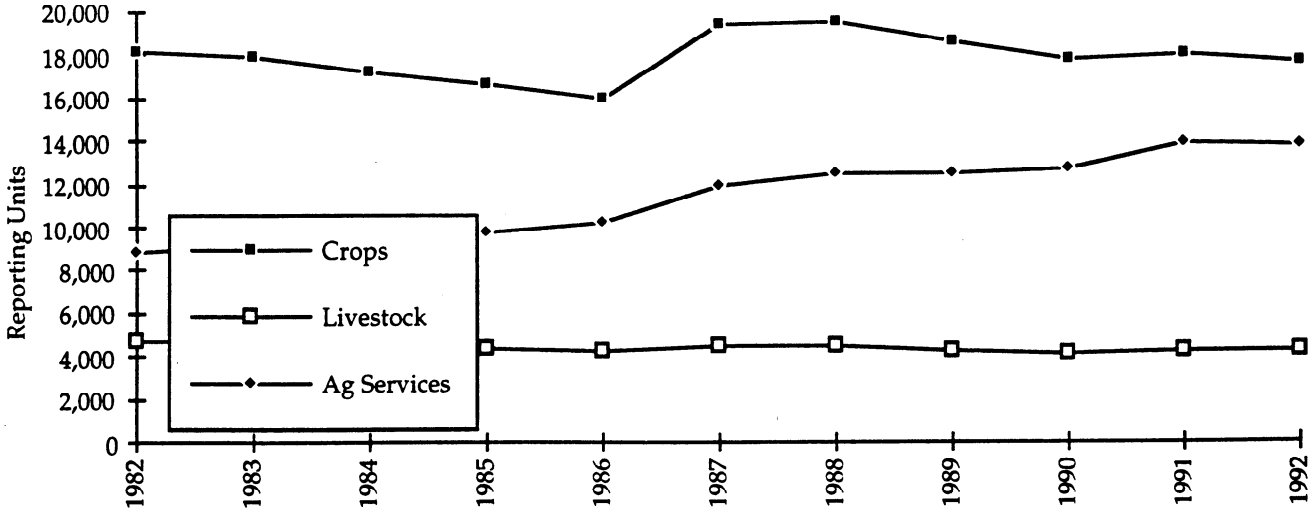
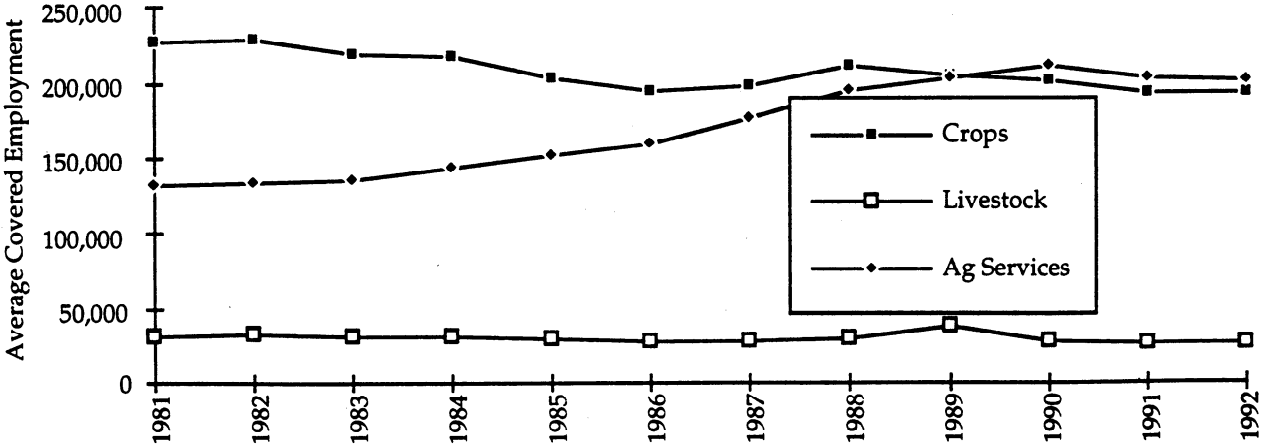


Figure 7. Agricultural UI Reporting Units from 1982 to 1992



Source: California Employment Development Department, Report 352, Various Years

Figure 8. Average UI-Covered Employment in California Agriculture: 1981-1992



Source: California Employment Development Department, Report 352, Various Years

Table 1. Agricultural* Employment and Wages Covered by Unemployment Insurance in 1990

State	FIPS Code	Employers	Percent Distribution	Avg. Ann. Employment	Percent Distribution	Wages ($millions)	Percent Distribution
Alabama	1	1,415	0.9%	13,628	1.0%	185.1	0.9%
Alaska	2	116	0.1%	565	0.0%	8.5	0.0%
Arizona	4	2,722	1.8%	33,504	2.3%	423.5	2.1%
Arkansas	5	1,461	1.0%	12,710	0.9%	182.4	0.9%
California	6	34,576	22.6%	437,507	30.6%	5,899.2	29.8%
Colorado	8	2,125	1.4%	17,733	1.2%	260.6	1.3%
Connecticut	9	2,212	1.4%	13,573	0.9%	251.1	1.3%
Delaware	10	363	0.2%	3,060	0.2%	52.7	0.3%
Florida	12	10,601	6.9%	141,845	9.9%	1,838.4	9.3%
Georgia	13	2,672	1.7%	25,746	1.8%	356.6	1.8%
Hawaii	15	548	0.4%	11,895	0.8%	233.0	1.2%
Idaho	16	1,206	0.8%	15,339	1.1%	202.1	1.0%
Illinois	17	4,009	2.6%	36,537	2.6%	607.3	3.1%
Indiana	18	2,304	1.5%	20,482	1.4%	289.3	1.5%
Iowa	19	1,703	1.1%	11,510	0.8%	159.6	0.8%
Kansas	20	1,541	1.0%	10,983	0.8%	178.1	0.9%
Kentucky	21	1,421	0.9%	12,068	0.8%	173.8	0.9%
Louisiana	22	1,547	1.0%	11,744	0.8%	149.1	0.8%
Maine	23	645	0.4%	4,946	0.3%	67.4	0.3%
Maryland	24	2,303	1.5%	17,719	1.2%	292.2	1.5%
Massachusetts	25	3,099	2.0%	15,519	1.1%	291.3	1.5%
Michigan	26	3,664	2.4%	30,418	2.1%	437.4	2.2%
Minnesota	27	2,287	1.5%	17,073	1.2%	264.8	1.3%
Mississippi	28	1,488	1.0%	13,542	0.9%	168.3	0.8%
Missouri	29	2,426	1.6%	16,402	1.1%	221.8	1.1%
Montana	30	627	0.4%	3,120	0.2%	39.8	0.2%
Nebraska	31	1,359	0.9%	9,179	0.6%	141.9	0.7%
Nevada	32	622	0.4%	5,005	0.4%	74.9	0.4%
New Hampshire	33	596	0.4%	3,064	0.2%	44.6	0.2%
New Jersey	34	4,412	2.9%	23,371	1.6%	427.3	2.2%
New Mexico	35	804	0.5%	11,216	0.8%	108.5	0.5%
New York	36	6,778	4.4%	39,368	2.8%	686.0	3.5%
North Carolina	37	3,063	2.0%	30,367	2.1%	426.5	2.2%
North Dakota	38	496	0.3%	2,126	0.1%	30.3	0.2%
Ohio	39	4,219	2.8%	34,330	2.4%	495.7	2.5%
Oklahoma	40	1,254	0.8%	8,832	0.6%	120.6	0.6%
Oregon	41	2,271	1.5%	29,270	2.0%	359.9	1.8%
Pennsylvania	42	4,459	2.9%	37,808	2.6%	603.5	3.0%
Rhode Island	44	630	0.4%	2,593	0.2%	44.1	0.2%
South Carolina	45	1,451	0.9%	12,956	0.9%	162.5	0.8%
South Dakota	46	467	0.3%	1,883	0.1%	29.5	0.1%
Tennessee	47	1,539	1.0%	12,469	0.9%	162.7	0.8%
Texas	48	11,293	7.4%	87,297	6.1%	1,100.9	5.6%
Utah	49	536	0.3%	4,312	0.3%	53.0	0.3%
Vermont	50	416	0.3%	2,374	0.2%	36.6	0.2%
Virginia	51	2,603	1.7%	23,249	1.6%	344.3	1.7%
Washington	53	11,701	7.6%	74,415	5.2%	733.1	3.7%
West Virginia	54	411	0.3%	3,099	0.2%	37.9	0.2%
Wisconsin	55	2,101	1.4%	18,642	1.3%	311.5	1.6%
Wyoming	56	380	0.2%	2,082	0.1%	26.4	0.1%
United States	57	153,105	100.0%	1,429,905	100.0%	19,822.1	100.0%

Source: Unpublished ES-202 data from the Employment and Wages Program; Bureau of Labor Statistics, U.S. Department of Labor.

* Agriculture includes reporting units with these SIC codes: crops (SIC=01), livestock (02) and agricultural services (07).
Most states have Federal Unemployment Tax Act coverage of farm employers; farm employers who pay quarterly cash wages of $20,000 or more or employ 10 or more workers for at least one day in each of 20 different weeks must cover their farm workers (20-10 rule). CA, ME, MN, RI, TX, and WA have more inclusive farm worker coverage.
Percent changes may be exaggerated in states, including WA and TX, that extended coverage beyond the Federal minimum during the 1980s.
Employers are reporting units, usually farms or their subunits which employ 50 or more workers.
Avg. Ann. Employment is the employer-reported count of all workers on the payroll for the pay period which includes the twelfth day of the month summed over 12 months and divided by 12.

Table 2. UI-Covered Agricultural* Employment and Wages: 1980-90

State	Percent Change: 1980-90 in UI Covered: Employers	Employment	Wages	States ranked by their 1980-90 Change in Ag Wages	
Alabama	65%	55%	145%	Idaho	286%
Alaska	134%	152%	193%	Virginia	286%
Arizona	76%	39%	87%	Vermont	239%
Arkansas	26%	20%	77%	Maryland	219%
California	8%	13%	74%	North Carolina	216%
Colorado	65%	54%	131%	Oregon	208%
Connecticut	75%	34%	193%	Georgia	194%
Delaware	80%	43%	151%	Connecticut	193%
Florida	79%	23%	101%	Alaska	193%
Georgia	88%	73%	194%	New Jersey	192%
Hawaii	64%	6%	61%	Nebraska	190%
Idaho	139%	161%	286%	Nevada	184%
Illinois	85%	93%	184%	Illinois	184%
Indiana	81%	72%	145%	Tennessee	172%
Iowa	33%	26%	60%	New Hampshire	172%
Kansas	56%	72%	148%	Utah	170%
Kentucky	86%	63%	143%	Massachusetts	167%
Louisiana	36%	20%	68%	South Carolina	166%
Maine	88%	40%	132%	Washington	164%
Maryland	98%	86%	219%	Rhode Island	161%
Massachusetts	131%	45%	167%	Pennsylvania	159%
Michigan	97%	68%	146%	Ohio	158%
Minnesota	30%	32%	116%	New York	157%
Mississippi	36%	3%	63%	Delaware	151%
Missouri	59%	48%	118%	Wisconsin	150%
Montana	83%	57%	125%	Kansas	148%
Nebraska	119%	110%	190%	Michigan	146%
Nevada	114%	119%	184%	Indiana	145%
New Hampshire	112%	82%	172%	Alabama	145%
New Jersey	72%	49%	192%	Kentucky	143%
New Mexico	54%	90%	122%	West Virginia	133%
New York	46%	48%	157%	Maine	132%
North Carolina	102%	79%	216%	Colorado	131%
North Dakota	-5%	17%	70%	Montana	125%
Ohio	45%	80%	158%	New Mexico	122%
Oklahoma	74%	45%	108%	Texas	120%
Oregon	65%	96%	208%	Missouri	118%
Pennsylvania	55%	56%	159%	South Dakota	117%
Rhode Island	48%	48%	161%	Minnesota	116%
South Carolina	78%	50%	166%	Oklahoma	108%
South Dakota	94%	44%	117%	Florida	101%
Tennessee	61%	61%	172%	Arizona	87%
Texas	148%	63%	120%	Wyoming	78%
Utah	74%	102%	170%	Arkansas	77%
Vermont	120%	100%	239%	California	74%
Virginia	111%	123%	286%	North Dakota	70%
Washington	357%	115%	164%	Louisiana	68%
West Virginia	49%	40%	133%	Mississippi	63%
Wisconsin	44%	61%	150%	Hawaii	61%
Wyoming	90%	28%	78%	Iowa	60%
United States	60%	39%	115%	United States	115%

Source: Unpublished ES-202 data from the Employment and Wages Program; Bureau of Labor Statistics, U.S. Department of Labor.

Table 3. Crop Workers Grouped by their Farm Jobs: 1990-91

Category (weeks)*	Seasonal or Periodic	Percent of Time	Regular or Long-Task	Percent of Time
Farmwork	31	60%	31	60%
Nonfarm work	5	10%	7	13%
Unemployment	7	13%	4	8%
Out of U.S.	6	12%	6	12%
Other	3	6%	4	8%
Total	52	100%	52	100%

*Weeks of farm and nonfarm work include weeks of less than full-time work. A worker was considered unemployed only if s/he was actively seeking work for a week during which no work was found. Periodic or seasonal workers had three or more less-than-six-week jobs. Regular or long-task workers had only farm jobs that lasted for six weeks or more.

Source: NAWS data from Mines, Gabbard, and Samardick, 1993, p. 11-12.

Table 4. Legalization Applicants

Characteristic	LAW (a)	SAW (b)
Median Age at Entry	23	24
1. Age 15 to 44 (%)	80	93
2. Male (%)	57	82
3. Married (%)	41	42
4. From Mexico (%)	70	82
5. Applied in California (%)	54	52
Total Applicants	1,759,705	1,272,143

Source: INS Statistical Yearbook, 1991, pp. 70-74
(a)Persons filing I-687 legalization applications
(b)Persons filing I-700 legalization applications. An additional 80,000 farm workers received legal status under the general or pre-1982 legalization program.

Box 1. Farming and Farm Employment

For purposes of the Census of Agriculture, a farm is "any place from which $1,000 or more of agricultural products were produced and sold or normally would have been sold during the census year," the years ending in 2 and 7. According to this definition, there were 2.1 million farms in 1991. About 20 percent of all farms are in Texas, Missouri, and Iowa. The largest 107,000 farms each sold farm products worth $250,000 or more, and they accounted for 56 percent of gross cash income. The smallest 1.3 million farms each sold farm products worth $20,000 or less, and they accounted for 5 percent of gross cash income. These small farms lost $500 million farming.

Farmers had cash marketing receipts of $170 billion in 1990, including 53 percent from the sale of livestock products and 47 percent from crop products. Production expenses were $144 billion, but with government payments and other farm cash income, net farm income was $51 billion. Exports of farm products in 1990 were $40 billion, or 11 percent of the total $366 billion in U.S. exports. U.S. imports of agricultural products were $23 billion, 5 percent of U.S. imports, leaving a net agricultural trade surplus of $17 billion.

The United States is a net exporter of the fruits and vegetables MSFWs pick. In 1990, U.S. farm exports included $3 billion worth of fruits and nuts (both fresh and processed), and $2 billion worth of vegetables (fresh and processed), up sharply from 1986 levels of $2 billion and $1 billion, respectively. Imports of fruits and nuts (fresh and processed) were worth $2.5 billion in 1990, and imports of vegetables were worth $2.3 billion. Tomatoes (fresh and processed) worth $400 million were the largest vegetable import.

About 4.6 million people lived on farms in 1990. However, most of the 2.5 million farm residents who are in the labor force are not employed in agriculture: 52 percent are employed off the farm. Most farm workers also live in towns and cities; although data are inadequate, it is believed that fewer than 10 percent of U.S. farm workers live on farms.

The U.S. Department of Agriculture and many farm organizations argue that farming is more important to the U.S. economy than employment and sales data would indicate. Employment on farms averaged 2.5 million in 1990, accounting for 2 percent of the nation's 117 million employed persons. Another 5.4 million workers were employed in industries that provide inputs to farmers – almost 3/4 of them provided farmers with services such as banking, research, and insurance. A further 13.2 American million were employed to manufacture and distribute food products, including 10 million employed in food retailing and restaurants. (Data drawn from the Census of Agriculture and USDA Economic Indicators of the Farm Sector.)

Box 2. NAWS Farm Worker Profile: 1989-91

1. Demographic Characteristics: Most farm workers are male, young, married, and immigrants with a SAW status
   - 73 percent are male; 67 percent are 35 or younger (median age 31).
   - 58 percent are married; 52 percent have children, and 60 percent do farm work accompanied by their families
   - 60 percent are foreign born, including 55 percent who were born in Mexico
   - 70 percent are Hispanic
   - 29 percent are SAWs; they have a median 7 years of U.S.. farm work experience
   - 10 percent are unauthorized; these young workers (median age 23) have only 2 years of U.S.. farm work experience
   - 53 percent of all SAS workers have 8 or fewer years of education (median 8 years); 65 percent speak primarily Spanish
   - 57 percent of the workers live with their families at the work site.

2. Farm Work and Earnings: Most workers experience extensive seasonal unemployment and have low annual earnings
   - Workers on average spend 50 percent of the year or 26 weeks doing Seasonal Agricultural Services work for 1.7 farm employers, 20 percent or 10 weeks unemployed, and 15 percent or 8 weeks doing non-SAS work and 15 percent or 8 weeks traveling abroad
   - 75 percent of all crop workers are employed in fruits or vegetables
   - 77 percent are hired directly by growers, usually to harvest crops
   - Median hourly earnings were $4.85; work weeks averaged 37 hours, for SAS earnings of $180 and, for 26 weeks, $4,665
   - Less than half of the workers have Unemployment Insurance and Workers Compensation coverage; 21 percent have off-the-job health insurance
   - 28 percent live in employer-provided housing

3. Other Work and Income: Farm workers are poor but not dependent on welfare
   - 46 percent of all SAS workers have below poverty level incomes, the poverty rate is highest for unauthorized workers (77 percent)
   - 36 percent also do non-SAS farm work; such work paid a median $4.50 per hour and is preferred to farm work
   - 40 percent of the workers spend an average 19 weeks abroad each year
   - Median individual incomes are $5,000 to $7,500; median family incomes are $7,500 to $10,000; 50 percent of the families are below the 1989 poverty line of $12,675 for a family of four
   - 55 percent of the workers own assets, usually a vehicle
   - 16 percent get food stamps; 3 percent Aid to Families with Dependent Children

   This table is based on quarterly interviews with 7,242 farm workers(for some questions) employed in Seasonal Agricultural Services (SAS) between the fall of 1989 and 1991. SAS is most of crop agriculture: it includes 80 percent of all farm workers, 70 percent of all farm jobs, and 60 percent of farm wages paid.

Source: Mines, *et. al.*, 1993

Box 3. Migrant and Seasonal Farm Workers

There are about 2.5 million hired farm workers in the United States. Of these, about 2 million help to produce crops on the nation's farms; crop production includes more seasonal employment peaks and troughs than livestock production, and hence most MSFWs are employed on crop farms. About half of these 2 million crop workers are employed more than 1 month in agriculture, but less than 10 months, and they depend on seasonal farm work for most of their earnings. These workers earn an average $5000 annually for 6 months of work on farms, or $5 billion annually.

According to the NAWS, the number of migrant farm workers who follow the crops from state to state numbers about 300,000. A larger number of workers--perhaps 600,000-- shuttle into the United States from their homes in Mexico, but then remain at one U.S.. residence while they do farm work. A few workers first shuttle into the United States and then follow the crops, for a total migrant work force of between 800,000 and 900,000.

Box 4. Farm Labor Contractors

Farm labor contractors (FLCs) are the intermediaries who match farm workers with jobs. Such intermediaries are common in labor markets in which immigrant workers are hired in crews for seasonal jobs. In these situations, the employer may want 20 to 40 crews, each with 30 to 40 worker, and the workers may need a bilingual contractor to find jobs for them.

FLCs in western agriculture were originally bilingual go-betweens. The Chinese workers who had been imported to build the transcontinental railroad in the 1860s were barred from urban jobs, and a bilingual "head boy" both worked and arranged seasonal farm jobs for his 20 to 30 compatriots. Japanese immigrants in the early 1900s also followed this intermediary-as-fellow-worker model, but in the 1920s, the FLC as an independent business person evolved. Farm workers went on strike against farmers who insisted on hiring workers through FLCs.

The federal government began to protect farm workers in the 1960s, and the first protective legislation was aimed at forcing FLCs to identify themselves by registering with the U.S.. Department of Labor. Many states also require FLCs to register, and both federal and state governments seek to discourage unscrupulous FLCs by requiring, in many states, that FLCs be fingerprinted, bonded, and tested for their knowledge of labor and pesticide regulations. For example, in California, a FLC must pay a $350 annual license fee, post a $10,000 bond, undergo a character investigation, and pass pesticide safety and labor law tests.

The intent of ever-stricter FLC regulation was to drive out of business those who could not operate lawfully. This strategy has not been successful: the 4,000 FLCs, and their 8,000 crew bosses, are as many as ever, and enforcement data suggest that labor law violations are common. Coordinated federal-state labor law enforcement in California in 1992-93 found major violations committed by 9 of 10 FLCs inspected.

FLCs evade effective enforcement of labor laws for a simple reason: they know the workers they hire and, as the U.S.. Industrial Commission explained in the early 1900s can thus "drive the hardest kinds of bargain" with them (quoted in Fisher, 1952, p. 43). Under such circumstances, it is hard to get farm workers to complain about labor law violations and, even they do, the general absence of written contracts makes it hard for often illiterate and non-English speaking workers to provide the evidence needed for effective enforcement.

Intermediaries are found in most seasonal farm labor markets. Not all are FLCs, but the workers' crew boss becomes in most instances the person on whom the worker depends. It is very difficult for a union to substitute for this often personal relationship.

Appendix

Foreign Workers Admitted for Temporary Employment in U.S. Agriculture by Year and Nationality, 1942-1993

Year	Total	Mexican	British West Indian[a,b]	Year	Total	Mexican	British West Indian[a,b]
1942[c]	4,203	4,203		1968	13,323	0	10,723
1943	65,624	52,098	13,526	1969	15,830	0	13,530
1944	83,206	62,170	19,622	1970	17,474	0	15,470
1945	72,900	49,454	19,391	1971	13,684	0	12,143
1946	51,347	32,043	13,771	1972	12,526	0	11,419
1947	30,775	19,632	3,722	1973	20,138		
1948[d]	44,916	35,345	3,671	1974	20,634		
1949	112,765	107,000	2,765	1975	16,499		
1950	76,525	67,500	6,225	1976	15,231		
1951	203,640	192,000[e]	9,040	1977	15,249[f]		
1952	210,210	197,100[e]	7,910	1978	15,441[f]		
1953	215,321	201,380[e]	7,741	1979	18,283		
1954	320,737	309,03[e]	4,704	1980	18,371		
1955	411,966	398,650[e]	6,616	1981	17,953		
1956	459,850	445,197[e]	7,563	1982	19,778		
1957	452,205	436,049[e]	8,171	1983	19,498		
1958	447,513	432,857[e]	7,441	1984	19,933		
1959	455,420	437,643[e]	8,772	1985	20,682		
1960	334,729	315,846[e]	9,820	1986	21,161		
1961	310,375	291,420[e]	10,315	1987	24,532[g]		
1962	217,010	194,978[e]	12,928	1988	23,745		
1963	209,218	186,865[e]	12,930	1989	26,607		
1964	200,022	177,736[e]	14,361	1990	25,412		
1965	35,871	20,284	10,917	1991	25,702		
1966	23,527	8,647	11,194	1992	18,700		
1967	23,603	6,125	13,578	1993	17246		

[a]Due to carryover of workers from year to year, the number admitted is sometimes less than peak employment.

[b]Includes Bahamians.

[c]Data from 1942 through 1947 were obtained from reports prepared by the U.S. Department of Agriculture.

[d]Data from 1948 through 1972 were compiled from administrative reports of the Manpower Administration, U.S. Department of Labor.

[e]Admitted under Public Law 78.

[f]The 1977 total does not include 809 aliens admitted by INS without DOL certifications; 1978 total does not include 148 workers admitted by INS.

[g]Employer applications filed prior to June 1, 1987 were processed according to the requirements of the H-2 program. Interim final regulations for the H-2A program, mandated by the Immigration Reform and Control Act of 1986, were promulgated on June 1, 1987, and all applications filed on or after that date were processed according to the H-2A program procedures. The 1987 total consists of 11,424 H-2 and 13,108 H-2A certifications.

[illegible] and Nature of Employer-Employee Relationships in the U.S. Labor Market

	Advantage (+) or Disadvantage (-)	Agricultural H-2 Employers	All Other U.S. Employers
FRINGES	+	6.13% discount because FICA tax on employers is not required	6.13% more because of FICA employer tax
	+	3.0 discount on average because of non-payment of unemployment insurance tax	Rate varies; virtually all employers must pay
	+	Off-job medical insurance (paid by worker)	Off-job medical insurance (often paid by employer)
WAGES	+	100% wage paid to workers (because no FICA worker tax)	93.87% of wages paid to worker (because of FICA worker tax)
	?	Employer's offer of wages must match but need not exceed a D/L established adverse effect wage rate (i.e., a limited risk)	Employer must meet competition in the open market (i.e., an unlimited risk)
GUARANTEES TO WORKERS	-	Work guaranteed for 3/4s of the time H-2s are employed	No such guarantee
	-	Employer pays transportation	Usually not required
	-	Adverse effect hourly wage rate established by D/L	No such rate
	?	Barracks housing provided for male workers	Housing may be provided for singles, families, or for none
	-	Deductions for meals regulated	No such regulations (usually)
	-	Workers' compensation mandatory	Varies from state to state (for agricultural employers)
GUARANTEES TO EMPLOYERS	+	Guaranteed supply of labor if regulations are met	No guarantee of work force
POTENTIAL REWARD SYSTEMS FOR EMPLOYERS	+	Employer can reward worker by making it possible for him to return to the U.S. subsequently	No comparable reward system
POTENTIAL PUNISHMENT SYSTEM FOR EMPLOYERS	+	Employer can cause worker to lose privilege to work in U.S. agriculture again	No comparable punishment system
PAPERWORK	+	No withholding of income tax	Required to withhold taxes
	-	Filing D/L and INS documents	No such requirement
	+	No filing of FICA reports	Required to file FICA reports
	+	No filing of UI reports	Required to file UI reports
SOCIAL COSTS (to the state and local governments)	+	Virtually none, as the workers' families are overseas	Normal costs of workers' families (education, social services, etc.)

Source: Center for Labor and Migration Studies, New TransCentury Foundation, Washington, D.C.

UNEMPLOYMENT INSURANCE FOCUS GROUPS: SAN FRANCISCO, CALIFORNIA—JANUARY 1994

SUMMARY

The Advisory Council on Unemployment Compensation sponsored two focus groups in San Francisco, California, on January 10, 1994, to gather opinions concerning the Unemployment Insurance (UI) system. Five broad areas were covered in each focus group. the five areas were the following: (1) general impressions of the UI program and the services provided to claimants, (2) the process of applying for and receiving benefits, (3) eligibility criteria, (4) adequacy of benefits, and (5) ways to improve the program.

Focus group participants disagreed on whether the UI program should operate as a social insurance program or as an entitlement program. Many believed, however, that the system should provide services other than just income support. Participants in both groups expressed a desire to receive career counseling and skills training.

Each focus group also discussed the process of applying for and receiving benefits. One area that many UI recipients indicated worked well was the delivery of benefits—their checks arrive regularly and on time. All participants, however, believed that claimants were treated poorly by UI staff. Many also believed minorities and non-English speakers were treated particularly poorly. Many felt that UI staff were inadequately trained or were being unhelpful simply to deny or delay the receipt of UI benefits. Since focus group participants believed they were entitled to benefits, they resented efforts by UI staff to determine whether they met the program's eligibility criteria.

Participants also liked the linking of benefit levels to previous income levels. Most indicated, however, that their benefits were inadequate and that the duration of benefits was too short. Various methods were discussed to raise benefit levels, including eliminating the current cap, guaranteeing a minimum benefit level, and indexing benefits to the cost of living in a given geographical area. Participants discussed a wide range of criteria that they believed should be used in determining program eligibility, including age, citizenship, and years of work experience. Many believed that receiving UI benefits was a right to which they were entitled and that continuing eligibility criteria, such as documenting work search or remaining "available" for work (and thus not in school), were either too restrictive or inappropriate.

Finally, participants discussed ways to improve the system. Most suggestions concerned methods to improve a UI claimant's initial contact with the UI system. Participants also discussed how to finance changes to the system. There was considerable confusion as to how the current system is financed; many participants believed incorrectly that both employers and employees currently make contributions. Many believed that any increases in taxes should be borne by both employers and employees.

UNEMPLOYMENT INSURANCE FOCUS GROUPS SAN FRANCISCO, CALIFORNIA—JANUARY 1994

INTRODUCTION

The Advisory Council on Unemployment Compensation sponsored two focus groups in San Francisco, California on January 10, 1994, to learn more about what Unemployment Insurance (UI) recipients think about the UI system. Although the results of these group discussions may differ significantly from the views of the entire population of UI recipients and therefore should thus not be used to form policy, they serve to highlight the function that many see the UI system serving, some of the areas that work well with the current system, as well as the areas that may need improvement.

The following five broad areas were covered in each focus group:

- General Impressions of the UI Program and the Services Provided to Claimants
- The Process of Applying for and Receiving Benefits
- Eligibility Criteria
- Adequacy of Benefits
- Ways to Improve the Program

Each focus group was approximately 90 minutes in length, and focus group participants were encouraged to participate actively in the discussions. Discussions were facilitated by a moderator to ensure that all topics were covered and that all participants had an opportunity to express their views. Participants were encouraged to disagree with the comments of others, rather than try to reach a consensus. This report summarizes the discussions that took place during these sessions, highlighting main themes when they emerged.

PARTICIPANT SCREENING PROCESS

Focus group participants were recruited with the assistance of staff from the Department of Labor (DOL) Region IX office, the California Employment Development Department, and the local UI offices in San Francisco. Notices were posted in each of the two local offices

instructing interested individuals to call a toll-free phone number. Callers were screened for eligibility based on three criteria:

- *Employment Status.* Only currently unemployed individuals were invited to participate.
- *Benefit Status.* Attempts were made to recruit only those currently receiving UI benefits.
- *Availability.* Callers who were not available during either of the two discussion sections and those unable to secure transportation to the focus group facility were screened out.

Although focus groups were filled on a space-available basis, attempts were also made to ensure that there was some diversity among discussants. Thus, an informal process was used to select participants using the following criteria:

- *Occupation.* Each caller was asked "What kind of work do you do?" to ensure that participants represented a wide range of occupations.
- *Gender.* Attempts were made to ensure that each group had both male and female participants.

Finally, discussants were paid a modest fee for participating and groups were filled quickly because of the overwhelming response to the notices.

PARTICIPANT CHARACTERISTICS

A total of 16 individuals participated in the focus groups: 7 in the first group and 9 in the second group. All participants had completed the UI application process, and the majority were receiving or had recently received benefits. Ten males and six females participated. Participants also came from a wide range of occupations. Each participant was placed in one of the two groups based on the occupation they self-reported. The first group was loosely defined as "blue collar." Self-reported occupations included pile driver apprentice, receptionist, janitor, welder, airline reservationist, warehouse worker, and clerk/receptionist. The second group was loosely defined as "white collar" or "professional." Self-reported occupations included nurse, public relations manager, legal assistant, accountant, graphic designer, retail salesperson, ballet dancer, marketing, and publishing. Years of work experience also varied considerably. Finally, participants represented many different racial and ethnic groups.

GENERAL IMPRESSIONS AND SERVICES AVAILABLE

What comes to mind when you think of Unemployment Insurance?

When asked what they thought of the UI system, almost all participants first noted their frustration with the system. In particular, they noted the long lines, the lack of information about how to receive benefits, and the unfriendly manner in which they were treated by the program staff.

Most believed that UI benefits are a right they had earned by working. Many believed that they were building a balance in their personal unemployment account when they were working, and that once they became unemployed, they should be entitled to draw on the balance in this account. Some confusion existed, however, as to whether the employer, the employee, or both pay taxes to support the system. Others viewed UI as a social insurance program that should be used to provide a safety net for the unemployed. Unlike proponents of the first view, they believed that the unemployed should be entitled to receive a given level of benefits regardless of how long they had worked.

What information or services are available to people who use the system?

Participants listed the following services available to those receiving UI benefits:

- Regular checks
- Job referral service
- Job information

In addition, participants suggested additional services that they thought would enhance the UI system. Participants in the "blue collar" group suggested the following services:

- Skill certification (e.g., administering typing or other skills-based tests and issuing certificates stating that the individual had met a certain standard)
- Videos outlining the steps in applying for UI benefits or looking for a new job
- Information on employers willing to hire and train unskilled labor
- Transportation assistance

Individuals in both focus groups believed that it would be desirable to offer career counseling and skills training to UI recipients to assist them in becoming reemployed. Participants expressed an interest in receiving training in a variety of areas, including computer

training, entrepreneurship, and training for skills needed in the beneficiaries' geographical area. Interest was also expressed in receiving on-the-job training.

PROCESS

Of the parts of the system you're familiar with, which parts worked well?

Participants indicated that once they had been found eligible to receive benefits, they received their checks fairly regularly. Also, many found the video explaining the application process helpful. Other aspects mentioned favorably by participants were the computer system, the job registration process, and the automated telephone response system that claimants can use to verify the status of their check.

In your opinion, which parts should be working better?

Participants indicated that there were numerous areas where the process of applying for and receiving benefits could be improved. In particular, participants mentioned the following:

- UI staff are not courteous enough
- UI staff are not knowledgeable or clear in describing how the application process works
- The lines are too long
- The forms are sometimes confusing
- It is difficult to understand how to initiate the process and what steps are involved
- Heavy workloads are not well managed
- Minorities are treated poorly
- There are not enough bilingual staff
- Job listings are not kept current (i.e., jobs are not removed from listings when they are filled)

How are the users of the system treated?

Many participants believed they were treated poorly. They complained that local UI staff did not seem knowledgeable about the process of applying for and receiving benefits or were unwilling to convey that information to their clients. Individuals in the "blue collar" group

indicated that the UI staff were often rude when dealing with them. A few individuals noted that some staff had been courteous, and most agreed that all UI staff seemed overworked. Nevertheless, participants believed that workloads might be handled better and that staff should be more courteous when dealing with individuals who had just lost their jobs.

Many participants indicated that they often felt as if UI staff were trying to find ways to deny or delay their benefits, rather than trying to facilitate their receipt of benefits. They believed that UI staff withheld information on how to correctly fill out the necessary forms or on what type of documentation was needed to determine eligibility. Since many thought that receiving UI benefits was a right they had earned, they believed that work search requirements were being used to inappropriately deny their benefits. Participants also believed that the requirement that an individual be ready and available for work should not preclude them from entering training programs, and that questions concerning training were also designed to deny benefits. Finally, UI staff efforts to determine the circumstances under which claimants left their jobs (i.e., whether they left their jobs voluntarily or were fired or laid off) and the accompanying appeal process were viewed both as unjustified and inappropriately favoring employers.

ADEQUACY

Are the benefits too little, too much, or the right amount?

The general consensus was that the benefits were inadequate. Participants noted that it was very hard to pay bills and rent on the UI benefits—that one "just can't make it on what they give you." The "professional" group discussed the fact that benefits are capped, a practice they thought was inappropriate.

How should the amount of money a person receives be determined?

Participants noted that the current system of tying benefit levels to previous income levels worked well, but that the replacement rate was too low. They discussed a number of factors that might be considered when determining the *level* at which benefits are determined. Participants suggested the following:

- Determining benefit levels as a percent of salary (not subject to a cap)
- Basing benefit levels on the cost of living in a given region
- Indexing benefit levels to inflation
- Guaranteeing that beneficiaries receive a minimum benefit
- Basing benefits on annual income (There seemed to be confusion on what basing benefits on the highest quarter in the last three quarters meant.)

Should everyone get the same amount of benefits?

As noted above, all participants believed that benefits should be tied to the amount of income previously earned. In addition, some believed it should be tied to how long a claimant had worked. A few participants noted that some states take dependents into consideration when determining benefit levels. The "professional" group thought that there should be a minimum payment.

Is the length of time people are entitled to benefits too long, not long enough, or the right length?

This question was only discussed in the "blue collar" group. Most participants in that group indicated that 26 weeks was not long enough. One participant, however, thought it would be preferable to receive higher benefits for a shorter period of time (or to at least have that option).

ELIGIBILITY

Who should be allowed to obtain benefits provided by the Unemployment Insurance system?

Participants discussed a wide range of criteria that could be used to determine program eligibility. Age, citizenship, length of employment, and reasons for being unemployed were the main criteria discussed for screening initial applicants. All focus group participants believed that UI recipients needed to have worked to qualify for benefits, although there was disagreement on how long an individual needed to work before being considered eligible to receive benefits. Many believed that UI recipients should be U.S. citizens. Some participants believed that individuals need to be at least 18 years old to qualify for benefits, while others thought that

anyone who met the other eligibility requirements should be eligible for benefits, regardless of age. Some participants believed that receiving UI benefits was a right for which they had worked, similar to Social Security income. They thought that anyone who had worked and paid into the system, or whose employer had paid into the system, should be entitled to receive benefits regardless of the circumstances under which they left their job. Other participants believed that the reason an individual left a job should be a relevant consideration in determining eligibility. Finally, participants felt too much emphasis was placed on the employers' perspective, as opposed to that of the claimant, in the determination of eligibility.

Do you think there should be requirements for receiving benefits?

Work search requirements were the main eligibility criteria discussed. Many focus group participants thought that the work search requirements were too restrictive, although for a variety of reasons. Participants believed that:

- The current system prevents workers from getting training that would make them more marketable
- Seasonal workers who are expected to return to work should not be required to make weekly job contacts
- It is difficult to document job search contacts
- UI recipients should not be required to document contacts since benefits are a "right" to which they are entitled

Since many focus group participants believed that they were either entitled to receive UI benefits or simply that they needed the money in order to survive, many agreed it was necessary to lie about whether they had met the work search requirements to obtain benefits. At least one participant, however, believed UI recipients should document work search in order to remain eligible for benefits. The other continuing eligibility criterion discussed was the amount of outside income an individual could receive without it affecting the recipient's benefit level. Only one individual raised this issue, noting that he thought it was too low.

Should everyone have to do the same things to get benefits and services?

Participants believed that the same eligibility criteria should be uniformly applied to different individuals when determining the level and duration of benefits. Many, however, believed that providing differential treatment to groups with special needs (e.g., elderly, injured, parents with small children, or those dismissed in mass layoffs) would be acceptable. They indicated that special extended hours or special lines might not only serve the needs of these individuals more quickly, but also expedite the process for all involved.

CHANGES

In addition to the things we've talked about tonight, are there any changes you'd like to see in the Unemployment Insurance system?

Participants offered several suggestions for other changes, most of which concerned improving the process and image of the UI system. They included the following:

- Simplifying the forms
- Increasing the local office staff
- Providing additional information on the process of applying for benefits in the local UI offices either by posting more signs or showing related videos
- Improving the physical condition of the offices

OTHER

Another topic raised for discussion concerned the program's financing. Participants in the "blue collar" group were asked if they believed employees or employers should pay for any increases in benefit levels. Some indicated that both groups should share the cost. Others, incorrectly believing that the current system is actually financed by both employees and employers, stated that any increases should be financed in the same way that benefits are now financed.

The "professional" group discussed whether they would be willing to have additional money taken out of their paychecks in order to receive additional benefits or training allowances when they were laid off. No clear consensus emerged from the group on either issue. Some participants supported the idea of paying extra taxes to ensure additional benefits, while others

did not. Those who supported the idea, however, thought they should be entitled to get the money back (for example by allowing workers to roll the money over into their Social Security account when they retired), even if they did not claim unemployment benefits. Similarly, some participants supported the idea of taxing workers to provide training between jobs, while others did not.

CONCLUSIONS

The focus group discussions highlighted several areas where the UI system is working well and several areas where it is not working well. Although participants disagreed on many topics, some areas of agreement did emerge. In general, UI recipients noted that once they were found to be eligible to receive benefits, their checks arrived reliably and on time. Participants also liked the current system of basing benefit levels on previous income. Most believed, however, that their benefits were inadequate and that the work search requirements were too restrictive. There was considerable disagreement on several topics: what the UI system is or should be (i.e., social insurance, an entitlement, etc.), what types of criteria should be applied to determine eligibility, and how any changes in the system should be financed. In addition, there was considerable misunderstanding about how the UI system is currently financed—most believed that both employers and employees make contributions (which is not true in California).

One theme that emerged consistently during the group discussions was the poor manner in which UI applicants are treated. Participants noted that they thought minorities and non-English speakers were treated particularly poorly. Many indicated that UI staff were uninformed or were being unhelpful simply in order to deny or delay the receipt of benefits; benefits to which many participants believed they had a "right" to claim. The problem is so severe that when asked what general impressions they had of the UI system, many discussants first noted the frustration they felt with receiving poor service.

This document was prepared by Robert Cook, Alexandra Tan, and Terri Thompson of KRA Corporation, in conjunction with ACUC staff.

An Analysis of the Unemployment Insurance Focus Groups Held in New York City September 8, 1994

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KRA
Corporation

Terri Thompson
Jenifer Elmas

1010 Wayne Avenue
Suite 850
Silver Spring, Maryland 20910

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Unemployment Insurance Focus Groups: A Summary

The Advisory Council on Unemployment Compensation continued its series of focus groups in New York City on September 8, 1994, to gather opinions about the Unemployment Insurance (UI) system. Each focus group discussed the following four broad areas:

- The process of applying for and receiving benefits
- Eligibility criteria
- Adequacy of benefits
- Ways to improve the system

In addition, one group was asked about general impressions of the UI program and service provided to claimants.

Focus group participants believed they made payroll contributions to the UI system; therefore, benefits provided are a right to which they are entitled. However, most respondents also believed that the system should provide other services in addition to income support. Participants in both groups expressed a desire to receive career counseling, job search assistance, and training.

Each focus group also discussed the process of applying for and receiving benefits. Many UI recipients indicated that the initial eligibility determination process worked well. However, participants believed that employers should not be consulted as part of this process. Many participants thought that UI staff treated claimants poorly, were inadequately informed, and were not helpful. Some participants also believed that minorities and non-English speakers were treated particularly poorly. These experiences indicate that the UI system may need to improve the service it provides to the unemployed, perhaps by improving workload management, reallocating program funds, or increasing administrative funding.

Participants liked the current system that ties benefit levels to previous income levels. Most participants indicated, however, that their benefits were inadequate in amount and duration of receipt. Various methods were discussed to raise benefit levels, including eliminating the current cap and raising the minimum benefit level. Many respondents believed that receiving UI benefits was a right to which they were entitled and that continuing eligibility criteria, such as documenting work search, were too restrictive. Finally, participants indicated that the current practice of deducting income earned during part-time employment from benefits was inappropriate.

Participants also discussed ways to improve the system. Most suggestions concerned higher benefit levels and the provision of job search assistance and training. There appeared to be some confusion about how the current system is financed; many participants believed that both employers and employees currently make contributions. Although the responses from the groups conducted in New York were similar to those from the groups conducted in San Francisco, it is difficult to gauge whether the experiences are representative of all UI recipients or are simply limited to the experiences of these participants or of claimants at a particular office.

Introduction

The Advisory Council on Unemployment Compensation sponsored two focus groups in New York City on September 8, 1994, to learn more about what Unemployment Insurance (UI) recipients think about the UI system. The results from these groups were similar to those from the groups held in San Francisco, California, in January 1994. However, the results of these group discussions may differ significantly from the views of the entire population of UI recipients and should not be used to form policy. Instead, they highlight the function that these respondents believe the UI system serves, including the areas that work well and the areas that they think need improvement.

Each focus group discussed the following four broad topics:

- The process of applying for and receiving benefits
- Eligibility criteria
- Adequacy of benefits
- Ways to improve the system

In addition, one group was asked about general impressions of the UI program and the services provided to claimants. Each focus group lasted approximately 90 minutes, and participants were encouraged to participate actively in the discussions. A moderator facilitated discussions to ensure that all topics were covered and that all participants had an opportunity to express their views. Participants were encouraged to disagree with each others' comments, rather than try to reach a consensus. Similarly, participants were free to change their stands on a particular issue if something was said during the discussion that caused them to reevaluate their opinions. This report summarizes the topics addressed during these sessions, highlighting main themes when they emerged.

Participant Screening Process

Participant recruitment and screening were conducted according to the same protocol used for the San Francisco groups. Focus group participants were recruited with the assistance of staff from the Department of Labor (DOL) Region II office and the local UI offices in New York City. Notices were posted in three local offices instructing interested individuals to call a toll-free telephone number. Callers were screened for eligibility based on the following three criteria:

- **Employment Status.** Only currently unemployed individuals were eligible to participate.
- **Benefit Status.** Attempts were made to recruit individuals currently receiving UI benefits or people who had received benefits in the recent past.
- **Availability.** Callers who were unavailable during both of the two discussion sessions or who were unable to secure transportation to the focus group facility were screened out.

Although focus groups were filled on a space-available basis, attempts were also made to ensure that there was some diversity among discussants. Therefore, an informal process was used to select participants according to the following criteria:

- **Occupation.** Each caller was asked, "What kind of work do you do?" to ensure that participants represented a wide range of occupations.

- **Gender.** Attempts were made to ensure that each group had both male and female participants.

Finally, discussants were paid a modest fee for participating.

Participant Characteristics

A total of 16 individuals participated in the focus groups: nine in the earlier group and seven in the later group. All participants had completed the UI application process, and the majority were receiving or had recently received benefits. Seven men and nine women participated. Participants also came from a wide range of occupations. Each participant was placed in one of the two groups based on the occupation they self-reported. The first group was loosely defined as "blue collar." Self-reported occupations included office assistant, chef, postal worker, word processor, copy shop employee, and parking lot attendant. The second group was loosely defined as "white collar" or professional. Self-reported occupations included actor, sales associate, human services worker, financial planner, and secretary. Years of work experience also varied considerably. Finally, participants represented many different races and ethnic groups.

General Impressions/Services

What comes to mind when you think of Unemployment Insurance?

> *Lines.*
>
> *Relief that perhaps you will have enough to pay the rent until you find another job.*
>
> *. . . it is kind of a safety net. As long as unemployment is there, you know that you have at least 6 months of something, which is better than nothing.*

When asked what they thought of the UI system, almost all participants first noted the inadequacy of the benefits and a sense of frustration with the system. Like the respondents in San Francisco, most believed that UI benefits were a right they had earned by working. Many participants believed that they were building a balance in their unemployment account while they were working and that when they were unemployed, they should be entitled to draw on the balance in this account. However, some confusion existed about whether the employer, the employee, or both pay taxes to support the system.

What information or services are available to people who use the system?

We shouldn't have to depend on the grapevine for information.

Participants in both groups felt that there was not enough information about the services that were available and where they were located. Participants noted the differing availability of services across local UI offices and expressed a desire to have "every available option" presented on their initial visit to the UI office.

Participants suggested additional services that they thought would enhance the UI system, including the following:

- A telephone question line that is accessible and answered by UI staff
- An onsite manager who can help with problems and answer questions or an advocate for the claimant who can assist with problems
- Individual skills assessments

Individuals in both focus groups believed that it would be desirable to offer career counseling and job search assistance to help them find new jobs. Participants expressed an interest in receiving training in a variety of areas, including training or education leading to a degree. Some respondents expressed concern that degreed programs were treated differently from vocational training. Specifically, they thought it was unfair that participation in vocational training did not preclude benefit receipt, but individuals working toward college degrees were considered unavailable for work and were therefore denied benefits.

Process

Of the parts of the system you're familiar with, which parts worked well?

The initial processing is pretty good.

I didn't know what I was doing, and the videotape was very helpful.

. . . on your first visit . . . they're very helpful.

Many participants agreed that the initial application and eligibility review process worked well. Specifically, the video explaining the application process and the booklet explaining benefits were considered helpful. Additionally, all but one of the participants believed that the touch-tone phone-in system was beneficial in ensuring timely receipt of benefits. However, participants noted that accessing the phone system was difficult and that additional lines or a toll-free number would be helpful. Finally, respondents agreed that all claimants should have to go through the same process to receive benefits, although they did suggest that there should be facilities for children accompanying their parents.

How are the users of the system treated?

. . . the attitudes I have to deal with . . . I come out upset.

. . . we can see how they look at you. He's unemployed . . . he's hustling.

Everybody's so rude; it's like a welfare office.

Like the respondents in San Francisco, many participants believed they were treated poorly. They complained that local UI staff did not seem knowledgeable about the process of applying for and receiving benefits or were unwilling to convey that information to their clients. Individuals in the blue-collar group indicated that the UI staff were often rude when assisting them. A few individuals noted that some staff had been courteous, but most agreed that all UI staff seemed overworked. Nevertheless, participants believed that workloads might be handled better and that staff should be more courteous when dealing with people who had just lost their jobs.

Adequacy

Are the benefits too little, too much, or the right amount?

How can you support yourself on half of what you used to make?

If I want to put 20 years into being a doctor, don't give me $150 if I go down to unemployment . . .

The money is small actually; it's not a lot of money.

The general consensus was that the benefits were inadequate. Participants noted that it was very hard to pay bills and rent on the UI benefits. The white-collar group discussed the fact that benefits were capped, a practice they thought was inappropriate. (Author's note: The maximum weekly benefit in New York is $300.)

How should the amount of money a person receives be determined?

It should go by what you're making.

What your needs are.

They should do an assessment . . . look at the individual.

Participants noted that the current system of tying benefit levels to previous income levels seemed fair, but that the replacement rate was too low. They believed that claimants should be assessed individually and benefit levels should be based on needs, including bills and dependents, as well as on previous income levels. A few participants thought there should be a minimum payment regardless of prior earnings. (Author's note: The minimum weekly benefit in New York is $40.)

Is the length of time people are entitled to benefits too long, not long enough, or the right length?

It should be for a year. It's hard to find a job out there.

They should be giving us 2 years automatic.

Although some participants suggested a set duration of benefit receipt for all claimants, others indicated that it should be tied to the claimant's work history. The latter group of participants believed that individuals who had worked longer should receive benefits for a longer period of time to allow for retraining or additional time to search for appropriate work. Furthermore, some respondents believed that a fixed duration of benefit receipt would be a disincentive to search for work.

Eligibility

Who should be allowed to obtain benefits provided by the Unemployment Insurance system?

Whoever has worked.

Anybody who pays into it.

People that have been laid off from work, don't have a job, who have been at the mercy of employers.

All focus group participants believed that UI recipients needed to have worked to qualify for benefits, although there was disagreement on how long an individual needed to work before becoming eligible to receive benefits. Some participants believed that seasonal workers should be allowed to collect benefits even if they were only employed for a few weeks. Finally, some participants believed that receiving UI benefits was a right for which they had worked, similar to Social Security income. They thought that anyone who had worked and paid into the system, or whose employer had paid into the system, should be entitled to receive benefits regardless of the circumstances under which he or she left his or her job. Other participants believed that the reason an individual left a job should be considered when determining eligibility and that quitting a job should not preclude benefit receipt. Furthermore, some participants believed that eligibility should be determined on a case-by-case basis and that the employer should not be consulted as part of the eligibility determination process.

Do you think there should be requirements for receiving benefits?

Yes. Or you fall into bad habits.

If you get a job that will take you 1 day, they deduct that from your unemployment insurance.

Work search requirements were the main continuing eligibility criteria discussed. A few focus group participants thought that the work search requirements were too restrictive, but others

believed that such requirements kept claimants from "getting lazy." The other continuing eligibility criterion discussed was the amount of outside income an individual could earn without affecting the recipient's benefit level. Respondents indicated that the current system of deducting income earned through part-time employment from benefits was inappropriate. They explained that many claimants must supplement their benefits with a part-time job to cover living expenses.

Changes

In addition to the things we've talked about tonight, are there any changes you'd like to see in the Unemployment Insurance system?

Participants indicated that there were numerous areas in which the process of applying for and receiving benefits could be improved. In particular, participants believed the following:

- UI staff are not courteous enough.
- UI staff are not knowledgeable about or clear in describing how the application process works.
- The lines are too long.
- Minorities are treated poorly.
- There is not enough communication between State UI systems, making interstate claims difficult.
- Job listings are not kept current (i.e., jobs are not removed from listings when they are filled).

Other

Another topic raised for discussion concerned the UI program's financing. Participants in the white-collar group were asked if they believed employees or employers should pay for any increases in benefit levels. Respondents generally believed that they were currently contributing to the system, and some participants indicated they would be willing to contribute more in order to receive increased benefits. Other participants believed that they currently contributed sufficiently through various taxes and were unwilling to contribute more, even to receive increased benefits.

Both groups expressed concerns about the cost of health insurance. Participants were concerned that benefit levels were inadequate to cover the high cost of health care, and some of them suggested that the UI system should assist claimants with obtaining affordable health insurance. Finally, some respondents indicated that businesses should use the UI system to help fill job openings, much like employers use temporary help services. Some participants suggested that employers receive a wage subsidy for employees hired through the UI system.

Conclusion

The focus group discussions highlighted several areas of the UI system that work well and several areas that do not work well. Although participants disagreed on many topics, some areas of agreement did emerge. In general, UI recipients noted that the initial eligibility review process worked effectively. Participants also liked the current system of basing benefit levels on previous income and work history. Some confusion existed about how the system is financed; most participants believed that they were paying into the UI system and that the benefits offered were a right to which they were entitled. One theme that emerged consistently during the group discussions was the lack of information provided to claimants. Many participants indicated that different services were offered at different offices and that often all service options were not explained. Although the responses from the groups conducted in New York were similar to those from the groups conducted in San Francisco, it is difficult to gauge whether the experiences are representative of all UI recipients or are simply limited to the experiences of these participants or of claimants at a particular office.

UNDERSTANDING DENIALS AND APPEALS IN THE UNITED STATES

Amy B. Chasanov and Eileen Cubanski
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Amy Chasanov and Eileen Cubanski are policy analysts at the Advisory Council on Unemployment Compensation. The views expressed in this paper are those of the authors and do not necessarily reflect those of the members of the Advisory Council on Unemployment Compensation. This is a preliminary draft and should not be quoted without the permission of the authors.

UNDERSTANDING DENIALS AND APPEALS IN THE UNITED STATES

Amy B. Chasanov and Eileen Cubanski

INTRODUCTION

The Unemployment Insurance (UI) program is intended to serve individuals with a substantial attachment to the labor force who are (1) involuntarily unemployed or voluntarily unemployed for good reason and (2) are able to work, available for work, and seeking work. Research has indicated that a decreasing percentage of the unemployed have received UI over time, indicating that the program itself has become less relevant. Significant research has been conducted to better understand the monetary eligibility criteria which establish a substantial labor force attachment as well as the nonmonetary eligibility conditions which ensure individuals are unemployed through no fault of their own and are able to work.[1]

This paper focuses on some of the reasons for the declining eligibility by examining the rates at which (1) state agencies detect nonmonetary eligibility issues, (2) state agencies decide to deny benefits to UI claimants, (3) employers and claimants appeal the state decisions, and (4) employers and claimants win the appeals they bring. Using aggregate state data between 1978 and 1990, this paper provides some answers to the variation across states in the four previously measures affecting UI recipiency. Using appeal-level data for Texas and Wisconsin, the paper attempts to draw conclusions regarding the rates at which appeals are made and which parties are likely to win their appeals.

OVERVIEW OF THE DETERMINATION PROCESS

The determination of ***monetary*** eligibility is a straightforward process that is based solely on the employment and earnings history of the UI applicant. In contrast, the determination of ***nonmonetary*** eligibility is frequently a more complex process, involving three general steps. First, the state agency must define and impose a set of nonmonetary eligibility requirements. Second, the state identifies potential nonmonetary eligibility issues in individual cases. Third, the state assembles information from the employer and claimant, considers the facts of the case, and makes a determination either denying or granting UI benefits to a claimant.[2]

There are a number of nonmonetary eligibility requirements that are applied when determining whether an individual claimant will be awarded UI benefits. In general, these require that (1) the individual demonstrates an ability and willingness to seek and accept suitable employment, and (2) there are no disqualifications related to the individual's most recent job separation. States *disqualify* individuals from receiving benefits for a number of reasons, including the following: (1) voluntary separation from work without "good cause," (2) discharge from employment due to misconduct connected with the job, (3) refusal of suitable employment without "good cause," (4) unemployment as a result of a labor dispute, or (5) fraudulent misrepresentation to obtain or increase UI benefits. The purpose of these restrictions is to limit payment to those workers who are unemployed primarily as a result of economic causes (U.S. Department of Labor 1994a).[3] Because almost all eligibility requirements for receiving Unemployment Insurance are determined by the states, the definitions vary significantly across states.

The impact of these definitions is determined most directly by the extent to which nonmonetary eligibility violations in specific cases are actually discovered. Just as there is significant variation across states in the definitions of nonmonetary eligibility that are applied in determining eligibility, there is also variation across states in the processes that are used to *detect* determination issues (i.e., the initial decisions to pursue additional information on a separation issue or a claimant's continuing availability for work). Consequently, the process of identifying and evaluating individual cases is an important step which ultimately determines the extent to which benefits are denied on the basis of nonmonetary eligibility provisions. While a complete description of the methods used in each state to detect and decide separation and nonseparation issues is not available, some general information is known. The process varies depending on whether the issue involves the initial separation from employment or a claimant's ongoing eligibility for UI benefits (i.e., nonseparation issues).

Determination Process for Separation Issues

The number of determinations for *separation* issues (i.e., issues related to an individual's separation from employment, such as voluntary separation from work without "good cause" and misconduct) depends primarily on (1) the claimant intake process and (2) information obtained from employers.

With regard to the intake process, the nature of the procedures that are followed may have a number of different effects, which include causing an increased number of determinations or discouraging individuals from applying for benefits. Variations in the intake procedures that could affect the number of determinations include the following: when information on nonmonetary eligibility requirements is provided to claimants (either before or after the intake process), whether the filing of additional forms is required at intake if a separation issue arises, and how questions are posed to claimants (e.g., whether a request is made for a claimant's submission of fact or a claimant's judgement call on the matter of whether the separation action was with "good cause").

With regard to the information obtained from employers, the procedures in place to solicit employer information may significantly affect both the level and the type of employer participation. Variations in the processes for obtaining employer information include the following: when and how information is gathered from employers (e.g., whether a form is sent out automatically with every application for UI benefits or all responsibility for contesting a claim originates with the employer), how the questions are posed to employers, and what types of follow-up measures are taken to ensure a response. In addition, the decision of individual employers to protest the eligibility of UI claims dictates the extent to which they participate in the UI system's eligibility determination process.

Determination Process for Nonseparation Issues

The number of determinations for *nonseparation* issues (i.e., the issues related to an individual's ongoing eligibility, such as ability to work, availability for work, and earning disqualifying income) depends largely on four types of information: (1) the intake form; (2) ongoing claims forms, which include information on claimants' job search; (3) Eligibility Review Program interviews; and (4) claimants' responses to referrals and job offers generated by the Employment Service. States vary in how frequently ongoing claims forms are required to be submitted, as well as in their interpretation and review of the information submitted on the forms. For example, states that randomly audit some portion of employer contacts required to prove job search activity or that review the ongoing claims forms in detail are more likely to detect an issue than states that lack review procedures or poorly enforce them. Similarly, states vary in their responses to Eligibility Review Program interviews and office appointments. In some

states, missing one appointment with UI staff is considered to be evidence of unavailability for work, whereas other states are concerned only with repeated broken appointments, and still other states never consider this to be a reason to initiate a determination.

OVERVIEW OF THE DENIAL PROCESS

After a determination issue is identified, a fact-finding process is undertaken to gather information from both claimants and employers. The state's laws and regulations are then applied to those facts, and a decision is made whether or not to award UI benefits to a claimant. Research indicates that the number of times a state denies benefits to UI claimants (on the basis of nonmonetary ineligibility) is more dependent on the number of determinations in a state than it is on the percentage of determinations that lead to denials (Corson et al. 1986, 22). Stated somewhat differently, there is significantly more fluctuation across states in determinations per initial claim than there is in the ratio of denials to determinations.

Corson et. al identified the following three additional factors which influence the denial rate: the extent to which all fact-finding is part of a recognized determination process, the extent to which states use in-person interviews, and the extent to which a single staff person conducts both fact-finding and adjudication.

OVERVIEW OF THE APPEAL PROCESS

In cases in which the above process results in a denial of UI benefits, the Social Security Act requires that each state provide an "opportunity for a fair hearing before an impartial tribunal."[4] Every state also allows employers to appeal UI benefit awards to claimants.[5] As a result of the 1971 U.S. Supreme Court decision in *California Department of Human Resources v. Java*, claimants who have been found eligible for benefits are allowed to continue receiving benefits until a decision is issued reversing the determination allowing benefits. Thus, an appeal filed by an employer does not stop payment of benefits to the claimant until the appeal has been decided in favor of the employer.

All states allow a claimant or employer at least one administrative appeal, usually called a lower authority or lower level appeal. The amount of time the claimant or employer has to file this appeal varies by state, ranging from 7 to 30 calendar days after a benefit determination is made.[6] In over one-half of the states, a single hearing officer, generally referred to as a

referee or examiner, decides the appeal at this stage. In the remaining states, either a referee or a panel comprised of a referee and two associates decides the lower authority appeal. The referee is typically an administrative law judge, while the associates are representatives of the interests of employers and claimants. During the appeal, the officer(s) hears evidence from both the claimant and employer, conducts a cross examination, and issues a written ruling, called a decision. This decision is final, pending further appeal, in all states except four, in which referees are permitted to reconsider their decisions within a certain time limit.[7]

Although not required by the Social Security Act, laws in all but three states also provide claimants and employers the opportunity to file a second administrative appeal, usually called a higher authority or higher level appeal.[8] Again, filing time varies across states, ranging from 8 to 30 calendar days after a lower authority appeal decision has been made. In about half of the states, a board of review or board of appeals is specifically formed to decide higher authority appeals. These boards are appointed by the Governor and consist of between three and seven members, who represent labor, employers, and the public.[9] In the other states, an existing commission or agency head serves as the higher appeal authority. Laws in all states allow these decisions to be appealed to the state courts for judicial review.

TRENDS IN DETERMINATIONS AND DENIALS

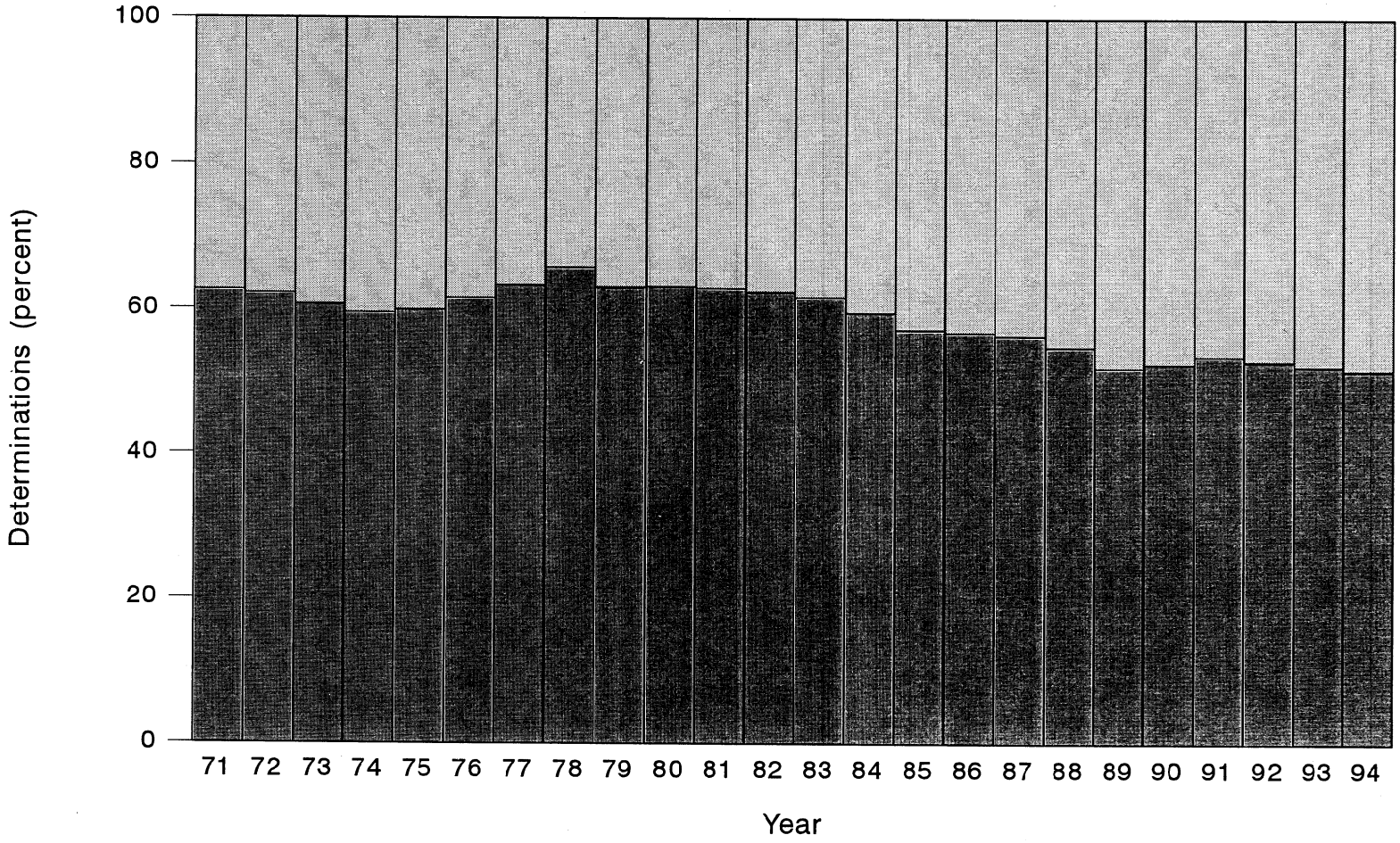
Determination Rates

In 1994, 37 percent of all new claimant spells in the United States resulted in some form of a nonmonetary determination. The total number of nonseparation determinations (3.4 million) was slightly higher than the number of separation determinations (3.2 million). Nonseparation determinations, however, have generally been decreasing and separation determinations have been increasing as a share of total determinations since 1978 (see Figure 1).

Determination Rates for Separation Issues

In 1994, approximately 18 percent of new claimant spells resulted in a *separation* determination. The ratio of separation determinations to new claimant spells has fluctuated over time, but has been increasing since its low of 11 percent in 1982 (column 1 in Table 1). Approximately half of the separation determinations in 1994 were for issues related to voluntary leaving and the other half were for misconduct.

FIGURE 1. Distribution of Determinations by Type, 1971-1994



SOURCE: Unemployment Insurance Required Reports.

TABLE 1. Determination Rates and Denials Rates, 1971-1994

	Separation Issues			Nonseparation Issues		
Year	Determination Rate per Initial Claim (percent)	Denials per Determination (percent)	Denial Rate per Initial Claim (percent)	Determination Rate per 10 Claimant Contacts (percent)	Denials per Determination (percent)	Denial Rate per 10 Claimant Contacts (percent)
1971	15	51	8	34	39	13
1972	17	53	9	39	38	15
1973	18	54	10	43	37	16
1974	15	55	8	35	38	13
1975	15	54	8	29	38	11
1976	18	54	10	41	37	15
1977	19	53	10	43	37	16
1978	20	53	11	49	36	18
1979	18	55	10	42	37	15
1980	14	57	8	31	41	13
1981	14	56	8	31	43	13
1982	11	55	6	23	46	11
1983	13	53	7	24	45	11
1984	14	53	7	27	46	13
1985	14	52	7	25	51	13
1986	15	53	8	25	56	14
1987	16	53	9	26	57	15
1988	17	54	9	27	57	15
1989	17	54	9	25	60	15
1990	16	55	9	23	62	14
1991	15	56	8	20	61	13
1992	16	56	9	20	61	12
1993	18	56	10	21	61	13
1994	18	56	10	21	60	13

SOURCE: Unemployment Insurance Required Reports.

Given the wide range in states' procedures for detecting nonmonetary eligibility issues, it is to be expected that determination rates vary significantly by state. The variation across states in determination rates for separation issues is shown in Table 2. (The first column of Table 2 displays the number of separation determinations per new UI spell and the second column displays the state rank, with the state with the highest determination rate, Nebraska, receiving a rank of 1.) The 1994 ratio of separation determinations to new claimant spells ranged from a low of 8 percent in the Virgin Islands and Kentucky to a high of 89 percent in Nebraska.[10] As mentioned previously, significant differences in determination rates across states are likely to arise due to different detection procedures, as well as varying definitions of what constitutes a determination.

Determination Rates for Nonseparation Issues

Because claimants may become ineligible at any time while receiving UI, nonseparation issues are usually expressed as a percentage of weekly claimant contacts (i.e., all weeks that UI benefits are claimed by active UI claimants). For purposes of this paper, nonseparation determinations are expressed per *10* weekly claimant contacts. In 1994, of every 10 claimant contacts, 2.1 (or 21 percent) resulted in a *nonseparation* determination (see column 4 of Table 1).

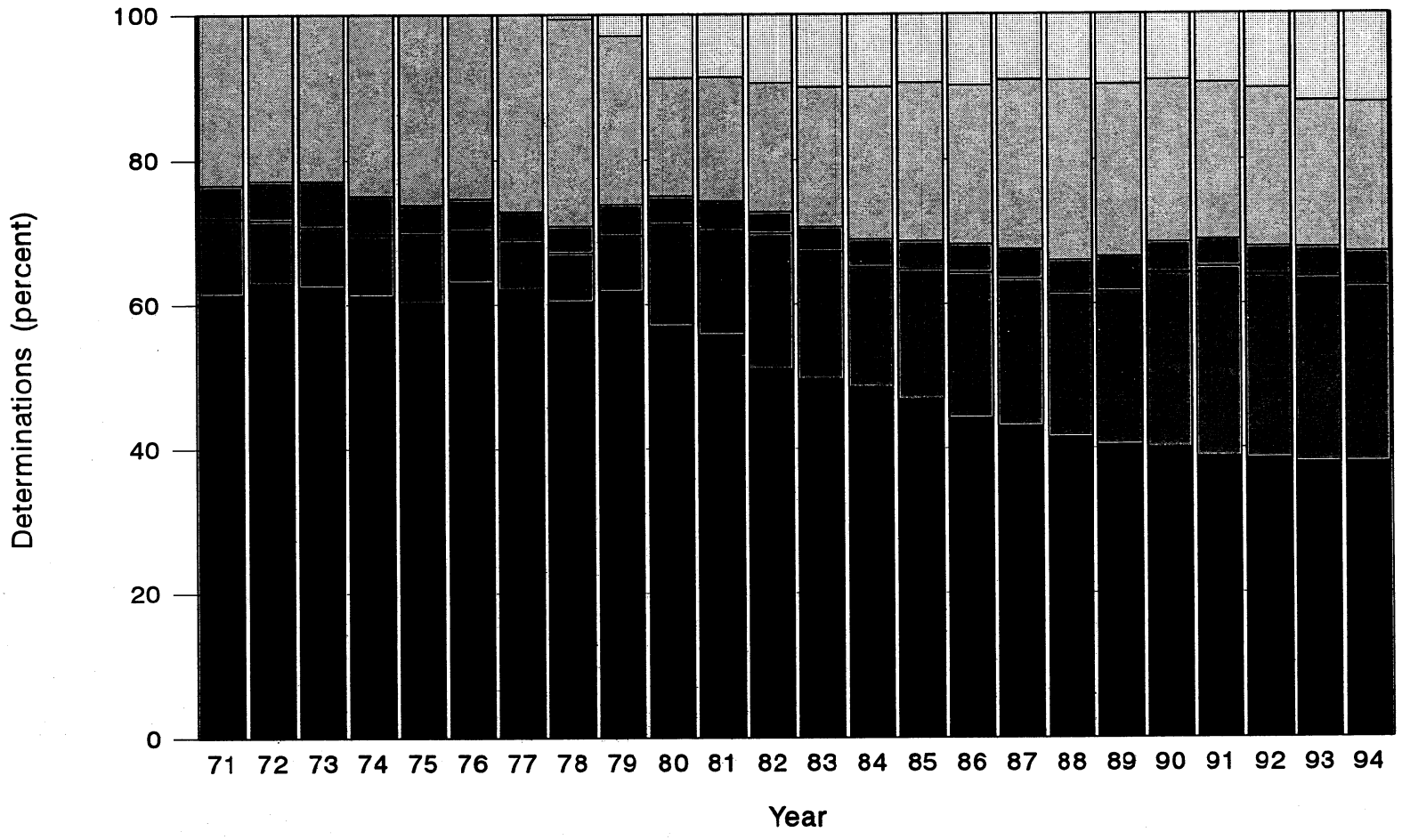
Thirty-eight percent of nonseparation determinations were due to "able and available" issues, 25 percent were due to claimants' earning potentially disqualifying income, 21 percent were due to reporting requirements, and 5 percent were due to refusal of suitable work (see Figure 2).[11] Over time, the determination rate for able and available issues has decreased, becoming a much smaller proportion of total nonseparation determinations.

By state, the 1994 rate of nonseparation determinations per 10 claimant contacts ranged from a low of 2 percent in Tennessee to a high of 84 percent in Utah (see column 1 in Table 3).

Denial Rates

The following two measures can be used to describe the frequency with which denials occur: (1) the ratio of denials to determinations, and (2) the ratio of denials to either new claimant spells (for separation issues) or weekly claimant contacts (for nonseparation issues). Table 1 displays both of these measures. Thus, the denial rate per new claimant spell (column 3 in

FIGURE 2. Distribution of Nonseparation Determinations by Issue, 1971-1994



SOURCE: Unemployment Insurance Required Reports.

TABLE 2. Determination Rates and Denials Rates for Separation Issues, By State, 1994

State	Determination Rate per Initial Claim (Rate)	(Rank)	Denials per Determination (Rate)	(Rank)	Denial Rate per Initial Claim (Rate)	(Rank)
Alabama	12%	48	78%	2	9%	28
Alaska	16	30	73	8	12	18
Arizona	30	7	57	30	17	8
Arkansas	18	26	75	5	13	13
California	15	34	47	41	7	42
Colorado	43	2	70	9	30	2
Connecticut	21	16	26	53	5	49
Delaware	19	25	74	6	14	12
District of Columbia	14	41	64	16	9	31
Florida	25	13	64	15	16	11
Georgia	21	18	63	18	13	15
Hawaii	17	28	50	37	8	34
Idaho	15	33	60	24	9	29
Illinois	20	20	57	29	11	21
Indiana	35	4	57	27	20	3
Iowa	19	22	57	28	11	23
Kansas	25	12	43	47	11	25
Kentucky	8	52	65	14	5	50
Louisiana	35	3	55	33	20	4
Maine	15	37	40	49	6	48
Maryland	27	9	70	10	19	5
Massachusetts	14	39	56	31	8	36
Michigan	21	17	60	23	13	16
Minnesota	16	29	45	46	7	41
Mississippi	23	14	75	4	17	7
Missouri	27	10	60	22	16	9
Montana	16	32	62	20	10	27
Nebraska	89	1	83	1	74	1
Nevada	33	5	56	32	18	6
New Hampshire	26	11	48	40	12	17
New Jersey	12	49	68	13	8	37
New Mexico	20	19	59	25	12	20
New York	15	36	51	36	8	40
North Carolina	12	45	69	12	9	32
North Dakota	14	40	47	43	7	46
Ohio	13	43	62	19	8	38
Oklahoma	23	15	59	26	13	14
Oregon	19	21	42	48	8	35
Pennsylvania	11	50	47	42	5	51
Puerto Rico	12	47	35	52	4	52
Rhode Island	12	46	49	39	6	47
South Carolina	14	42	77	3	11	26
South Dakota	19	23	63	17	12	19
Tennessee	10	51	69	11	7	43
Texas	32	6	50	38	16	10
Utah	28	8	40	50	11	22
Virgin Islands	8	53	46	45	4	53
Virginia	16	31	53	35	8	33
Vermont	15	35	73	7	11	24
Washington	17	27	53	34	9	30
West Virginia	13	44	61	21	8	39
Wisconsin	15	38	46	44	7	45
Wyoming	19	24	36	51	7	44

SOURCE: Unemployment Insurance Required Reports.

TABLE 3. Determination Rates and Denials Rates for Nonseparation Issues, By State, 1994

State	Determination Rate per 10 Claimant Contacts (Rate)	(Rank)	Denials per Determination (Rate)	(Rank)	Denial Rate per 10 Claimant Contacts (Rate)	(Rank)
Alabama	53%	3	84%	10	45%	2
Alaska	30	13	70	25	21	13
Arizona	44	7	70	26	30	8
Arkansas	20	24	85	7	17	16
California	21	23	63	32	13	26
Colorado	38	10	90	4	34	6
Connecticut	22	22	48	49	10	34
Delaware	10	46	88	5	8	40
District of Columbia	7	52	75	20	5	50
Florida	8	48	78	16	6	45
Georgia	13	43	94	2	12	31
Hawaii	17	35	75	19	13	27
Idaho	35	11	99	1	35	5
Illinois	18	30	51	48	9	38
Indiana	18	31	85	8	15	19
Iowa	17	34	58	37	10	36
Kansas	26	18	65	30	17	17
Kentucky	8	49	68	27	5	49
Louisiana	30	14	86	6	26	11
Maine	50	5	59	36	30	9
Maryland	24	20	58	38	14	24
Massachusetts	15	39	55	41	9	39
Michigan	19	27	54	44	10	35
Minnesota	19	26	82	13	16	18
Mississippi	23	21	53	45	12	30
Missouri	38	9	84	12	32	7
Montana	12	44	56	39	6	44
Nebraska	76	2	79	15	60	1
Nevada	18	29	84	11	15	20
New Hampshire	52	4	55	43	28	10
New Jersey	13	41	55	42	7	42
New Mexico	16	38	39	52	6	46
New York	25	19	47	50	12	32
North Carolina	17	36	74	21	12	28
North Dakota	20	25	75	17	15	21
Ohio	13	42	61	33	8	41
Oklahoma	11	45	60	35	7	43
Oregon	18	32	79	14	14	23
Pennsylvania	27	17	18	53	5	51
Puerto Rico	16	37	72	22	12	33
Rhode Island	17	33	70	24	12	29
South Carolina	9	47	63	31	6	48
South Dakota	49	6	75	18	37	4
Tennessee	2	53	67	29	1	53
Texas	27	15	53	46	14	22
Utah	84	1	53	47	44	3
Virgin Islands	7	50	84	9	6	47
Virginia	27	16	92	3	25	12
Vermont	14	40	68	28	10	37
Washington	19	28	71	23	13	25
West Virginia	7	51	56	40	4	52
Wisconsin	30	12	61	34	18	15
Wyoming	41	8	45	51	18	14

SOURCE: Unemployment Insurance Required Reports.

Table 1) depends on both the determination rate per new claimant spell (column 1) and the denial rate per determination (column 2).[12] Table 1 shows that in 1994, 56 percent of all *separation* determinations resulted in denials and 60 percent of all *nonseparation* determinations resulted in denials.

Denial Rates for Separation Issues

In 1994, approximately 10 percent of all new claimant spells resulted in a *separation* denial (see column 3 in Table 1). The ratio of separation denials to new claims has fluctuated over time, but has been increasing since a low of 6 percent in 1982.

In 1994, the percentage of determinations that resulted in denial was 72 percent for voluntary leaving issues and 41 percent for misconduct issues. Thus, voluntary leaving determinations are more likely to result in a denial of benefits than misconduct determinations. In the majority of states, these denials resulted in a disqualification of benefits for the duration of the individual's unemployment spell.

By state, the 1994 percentage of new claimant spells that resulted in a separation denial ranged from a low of 4 percent in Puerto Rico and the Virgin Islands to a high of 74 percent in Nebraska.[13] The fifth column of Table 2 displays the number of separation denials per new claimant spell and the sixth column displays the state rank.

Denial Rates for Nonseparation Issues

In 1994, of every 10 claimant contacts, 1.3 (or 13 percent) resulted in a *nonseparation* denial. Although the nationwide rate of nonseparation denials per determination has increased significantly over time, the rate of nonseparation determinations per claimant contact has decreased (see columns 4 and 5 in Table 1). Over time, this has resulted in a fairly steady rate of nonseparation denials per claimant contact. In 1994, 37 percent of denials were for able and available issues, 25 percent were due to disqualifying income, 22 percent were due to reporting requirements, and 2 percent were due to refusal of suitable work.[14]

In 1994, nonseparation denials were most likely to occur in determinations involving violations of reporting requirements (66 percent of determinations were denied), earning disqualifying income (61 percent denied), or being unable or unavailable for work (59 percent denied). Denials for these issues resulted in a temporary denial of benefits; as soon as the

claimant's condition changes, however, he or she regained UI benefits. Only 28 percent of determinations related to refusing suitable work resulted in a denial of benefits. (In most states, an individual disqualified for this issue would subsequently be ineligible for benefits for the remainder of his or her unemployment spell). Over time, the rate at which denials are made per determination has increased significantly for able and available issues, as well as reporting requirements. The rate has remained fairly stable in regard to other issues.

Table 3 shows that the 1994 rate of nonseparation denials per 10 claimant contacts ranged from a low of 1 percent in Tennessee to a high of 60 percent in Nebraska.

Summary

The number of times a state denies benefits to UI claimants on the basis on nonmonetary eligibility issues is more dependent on the number of determinations than the percentage of determinations that lead to denials. Currently, 10 percent of all new claimant spells result in a separation denial and 1.3 percent of all claimant contacts result in a nonseparation denial. While there have not been large shifts in the nationwide denial rates, the overall rate of determinations has been increasing and the percentage of determinations resulting in a denial has been decreasing, for both separation and nonseparation issues. In addition, some nonmonetary issues are more likely to result in denials than others. Most notably, voluntary leaving issues and violations of reporting requirements are most likely to result in denials, and issues related to misconduct and refusal of suitable work are least likely to result in denials. There is large variation across states in their reported determination and denials rates.

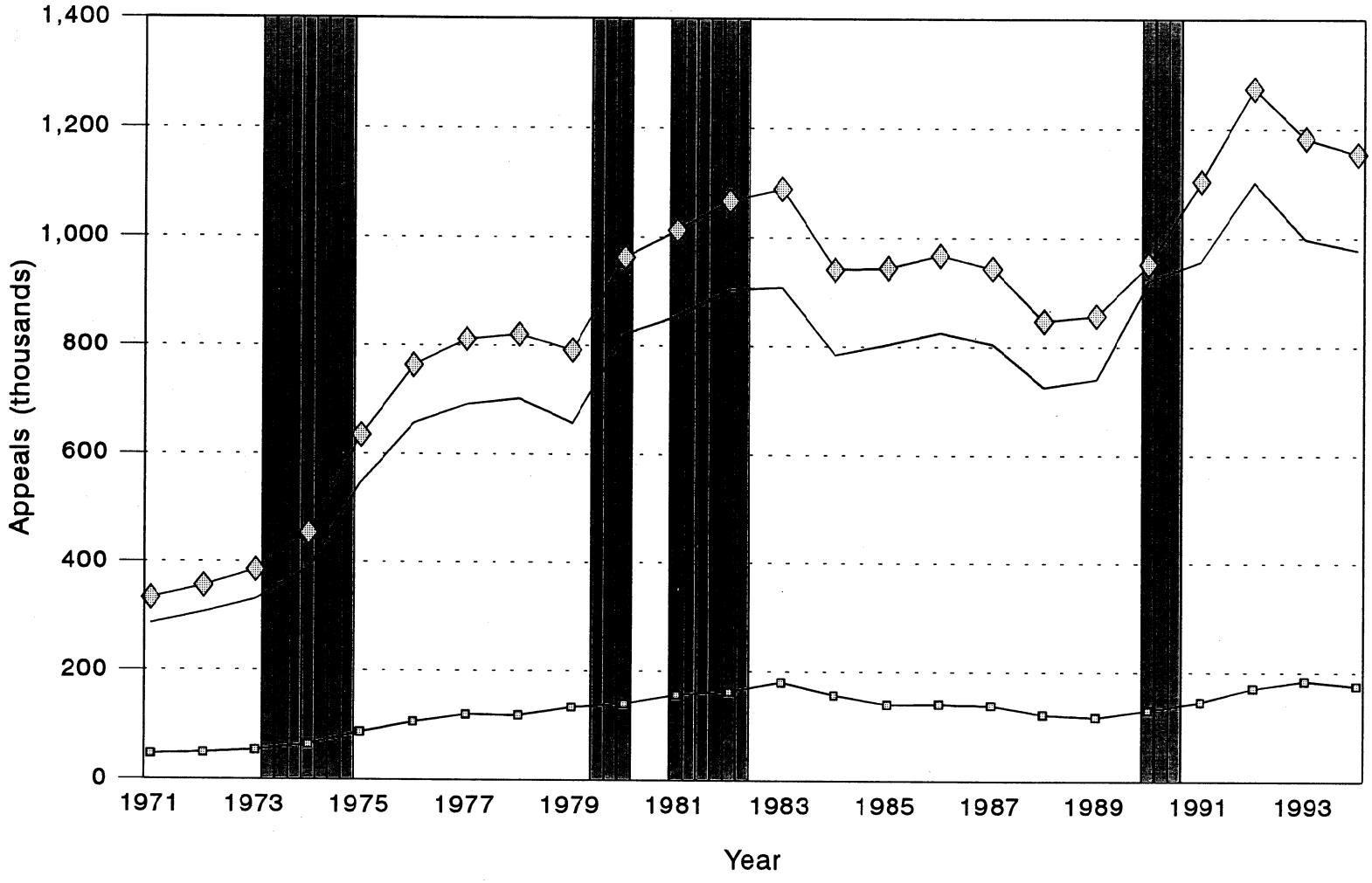
TRENDS IN APPEALS

Because of data limitations, all trends in appeals are examined using data on lower and higher authority *appeals decisions*, rather than data on the *number of appeals filed*. Consequently, the terms "appeals" and "decisions" are used interchangeably throughout this section to refer to appeal decisions.[15]

Lower and Higher Authority Appeals

Total appeals increased substantially between 1971 and 1994, with 1.2 million total appeals decisions in 1994, over 3 times greater than the total in 1971 (see Figure 3). Lower authority

FIGURE 3. Total Lower and Higher Authority Appeals, 1971-1994



NOTE: Shaded regions represent recession from peak to trough.
SOURCE: Unemployment Insurance Required Reports.

appeals constitute the majority of all appeals and are also responsible for most of the increase in the number of total appeals. The number of lower appeals decisions in 1994 was almost one million, over 3 times greater than in 1971.

The level of appeals increased around recessionary periods, in large part because of the increased number of initial claims for UI benefits filed during recessions. In addition to recession-induced increases in appeals, there has been a steady increase over time; as a percentage of initial claims, lower authority appeals have increased from 1.8 percent in 1971 to 5.6 percent in 1994 (see Figure 4). Similarly, lower authority appeals expressed as a percentage of total denials have increased sharply, from 11 percent in 1971 to 26 percent in 1994.[16]

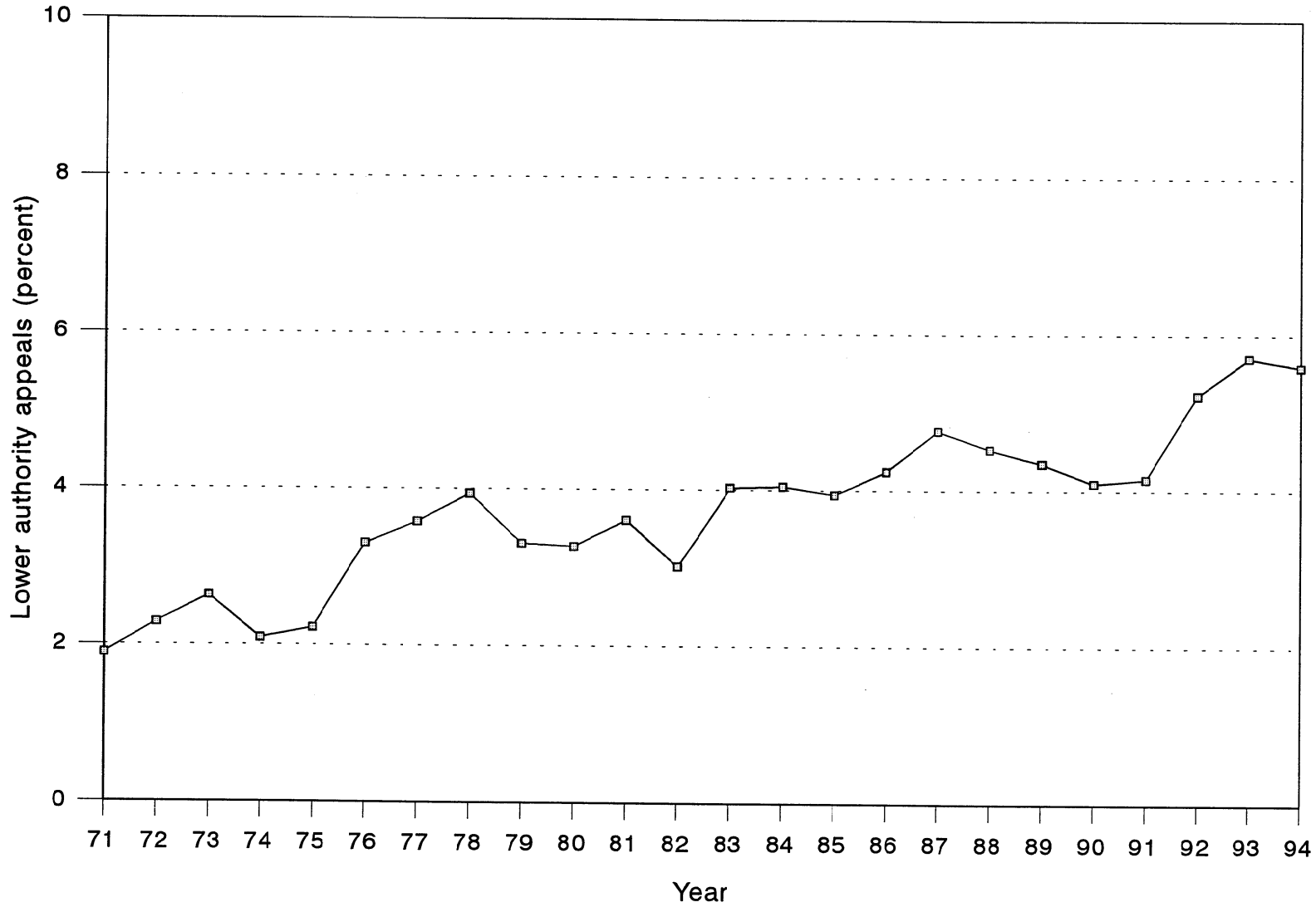
Higher authority appeals comprise a much smaller proportion of total appeals than lower authority appeals. Higher authority appeals, however, also display a steady upward trend between 1971 and 1994 (see Figure 3). The number of higher authority appeals in 1994 was 180,000, almost 4 times greater than in 1971. As a proportion of lower authority appeals decisions, higher authority appeals have remained relatively constant, fluctuating between about 15 percent and 20 percent over the past 23 years.

By state, these numbers vary greatly. Table 4 displays the percentage of initial claims that are denied and appealed in each state in 1994. Tennessee had the lowest percentage of denials per initial claim at 7.8 percent, while Nebraska had the highest at 122.5 percent.[17] Total lower authority appeals as a percentage of initial claims ranged from 1.7 percent in Idaho to 14.4 percent in Colorado. Appeals as a percentage of denials ranged from 4.2 in Nebraska to 72.7 in the District of Columbia.[18]

Lower Level Appeals Decisions By Issue

Between 1971 and 1994, appeals resulting from denials of separation determinations accounted for, on average, about 60 percent of all lower authority appeals, while appeals of denials of nonseparation determinations accounted for about 40 percent of the total. The share of separation appeals has increased slightly throughout the 1980s and early 1990s, equaling 67 percent of total decisions in 1994. As shown in Figure 5, separation appeals as a percentage of separation denials increased from about 15 percent in 1971 to about 38 percent in 1994, while nonseparation appeals as a percentage of nonseparation denials increased from 8 percent to 16 percent.

FIGURE 4. Total Lower Authority Appeals as a Percentage of Total Initial Claims, 1971-1994



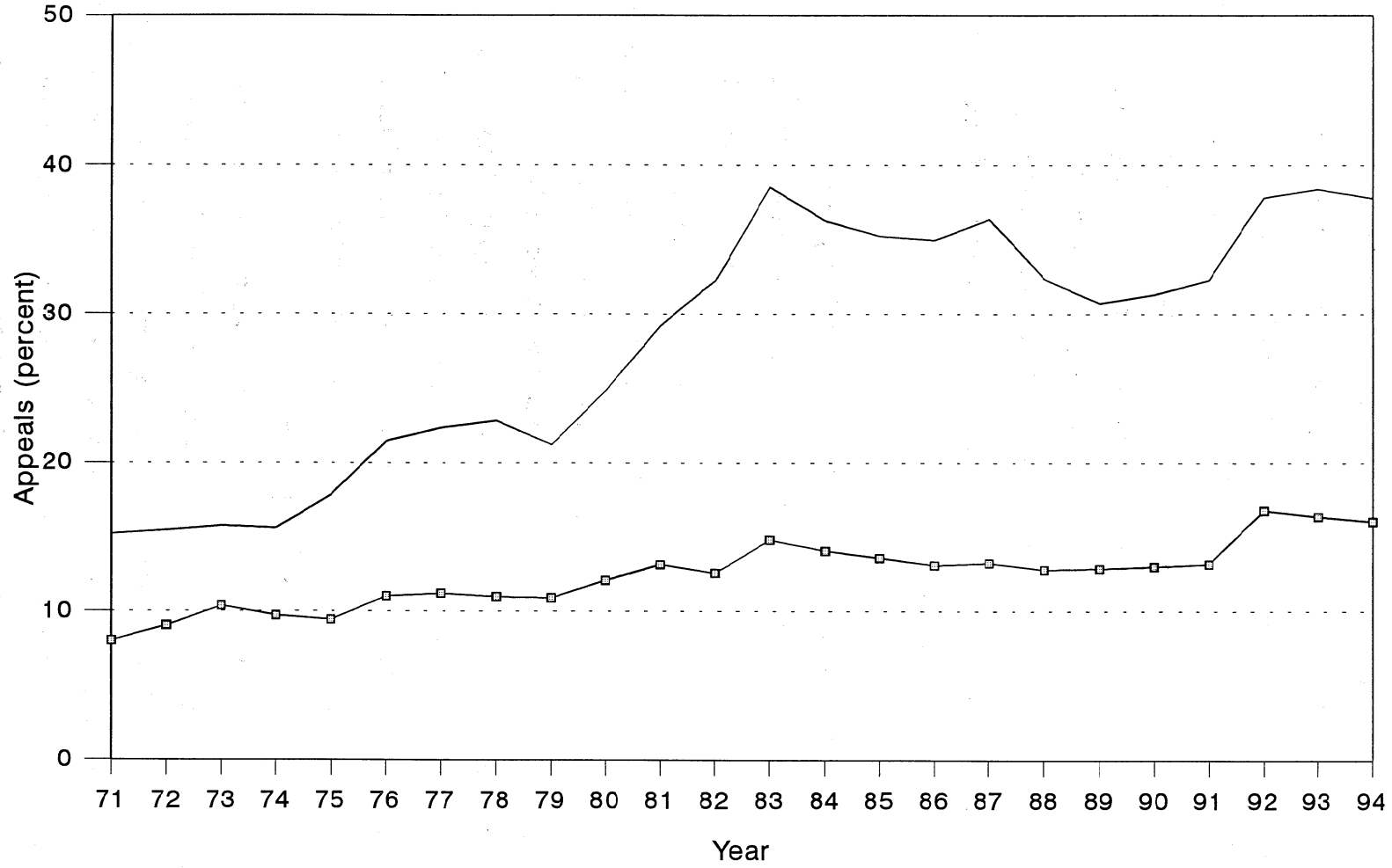
SOURCE: Unemployment Insurance Required Reports.

TABLE 4. Denials and Appeals as a Percentage of Initial Claims, By State, 1994

State	Denials as a Percentage of Initial Claims (Rate)	(Rank)	Appeals as a Percentage of Denials (Rate)	(Rank)	Appeals as a Percentage of Initial Claims (Rate)	(Rank)
Alabama	37%	8	13%	47	5%	3
Alaska	30	16	10	49	3	48
Arizona	49	3	24	29	12	2
Arkansas	26	19	21	36	5	27
California	18	36	25	26	5	35
Colorado	62	2	23	30	14	1
Connecticut	17	41	38	10	6	21
Delaware	22	26	34	14	7	17
District of Columbia	16	44	73	1	11	3
Florida	23	22	43	7	10	10
Georgia	20	30	28	20	6	25
Hawaii	20	31	22	32	4	36
Idaho	34	11	5	50	2	51
Illinois	21	29	40	8	8	15
Indiana	32	12	27	24	9	12
Iowa	19	33	54	3	11	4
Kansas	26	17	40	9	10	6
Kentucky	8	50	37	12	3	47
Lousiana	43	5	24	28	10	5
Maine	31	14	16	44	5	30
Maryland	34	10	29	19	10	8
Massachusetts	18	39	32	16	6	26
Michigan	21	28	16	45	3	46
Minnesota	24	20	25	27	6	22
Mississippi	26	18	31	18	8	16
Missouri	41	6	18	42	7	18
Montana	16	42	11	48	2	50
Nebraska	123	1	4	51	5	28
Nevada	31	13	27	23	9	13
New Hampshire	35	9	17	43	6	24
New Jersey	16	43	38	11	6	23
New Mexico	18	38	56	2	10	7
New York	22	25	23	31	5	31
North Carolina	14	46	26	25	4	43
North Dakota	18	37	28	22	5	29
Ohio	15	45	14	46	2	49
Oklahoma	19	34	43	6	8	14
Oregon	19	35	21	34	4	41
Pennsylvania	9	49	46	4	4	39
Rhode Island	17	40	19	40	3	45
South Carolina	14	47	28	21	4	42
South Dakota	37	7	18	41	7	20
Tennessee	8	51	46	5	4	44
Texas	30	15	32	15	10	9
Utah	48	4	20	39	10	11
Vermont	21	27	21	37	4	37
Virginia	23	21	20	38	5	34
Washington	22	24	21	35	5	33
West Virginia	12	48	37	13	4	38
Wisconsin	20	32	22	33	4	40
Wyoming	22	23	32	17	7	19

SOURCE: Unemployment Insurance Required Reports.

FIGURE 5. Separation and Nonseparation Appeals as a Percentage of Denials, 1971-1994



SOURCE: Unemployment Insurance Required Reports.

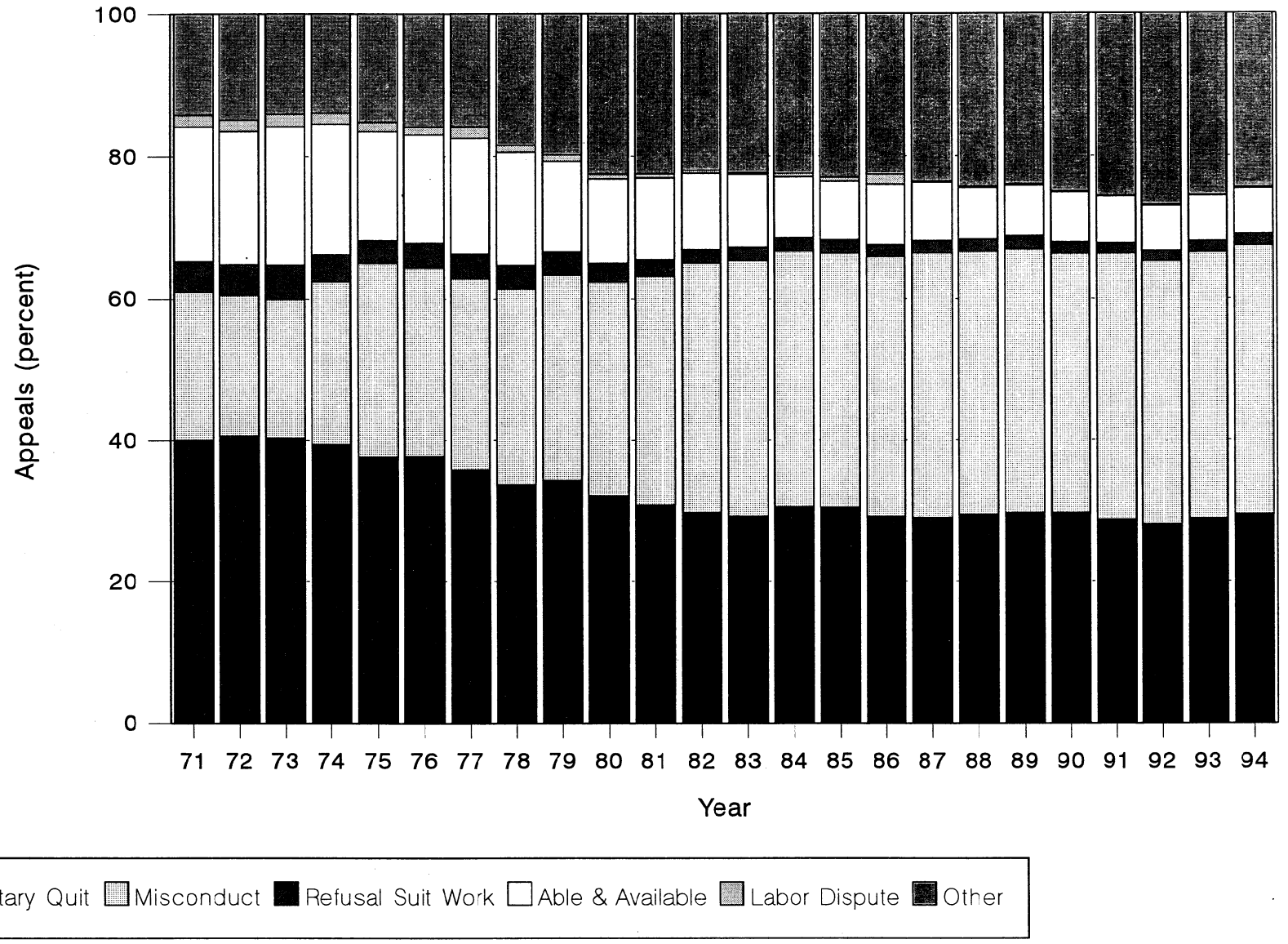
Furthermore, there have been substantial changes in the issues involved in lower authority appeals (see Figure 6). Appeals of misconduct disputes have almost doubled since 1971. By 1994, misconduct appeals made up the largest proportion of total lower authority appeals, at 38 percent. Appeals of voluntary quit disputes, on the other hand, have decreased from 40 percent of total lower authority appeals in 1971 to 30 percent in 1994. As a percentage of total lower authority appeals, appeals of refusal of suitable work, able and available for work, and labor dispute issues were all significantly lower in 1994 than in 1971 (equalling 2 percent, 6 percent, and less than 1 percent, respectively, of total lower appeals in 1994). Other nonseparation appeals, which include issues of receiving disqualifying income and failing to comply with reporting requirements, were almost 2 times greater in 1994 than in 1971, equalling 24 percent of total lower authority appeals in 1994.[19]

Lower and Higher Authority Appeals by Claimants and Employers

Between 1971 and 1994, there have been two significant trends related to the party (claimant or employer) who files an appeal, and the party who wins an appeal.[20] The first trend relates to claimant and employer appeals filed as a proportion of unfavorable determinations received (the appeals rate). Overall, claimants file more lower and higher authority appeals than employers. Claimant appeals made up about 74 percent and 68 percent of lower and higher authority appeals, respectively, in 1994. However, employers' lower authority appeals rates have increased more than claimants' in the past 10 years. The employers' rate of lower authority appeal has doubled over this period, from 5 percent in 1983, to 10 percent in 1994, while the claimants' rate has levelled off (see Figure 7). In contrast, as shown in Figure 8, trends in the ratios of higher authority appeals to unfavorable lower authority appeals have been similar for claimants and employers between 1971 and 1994.

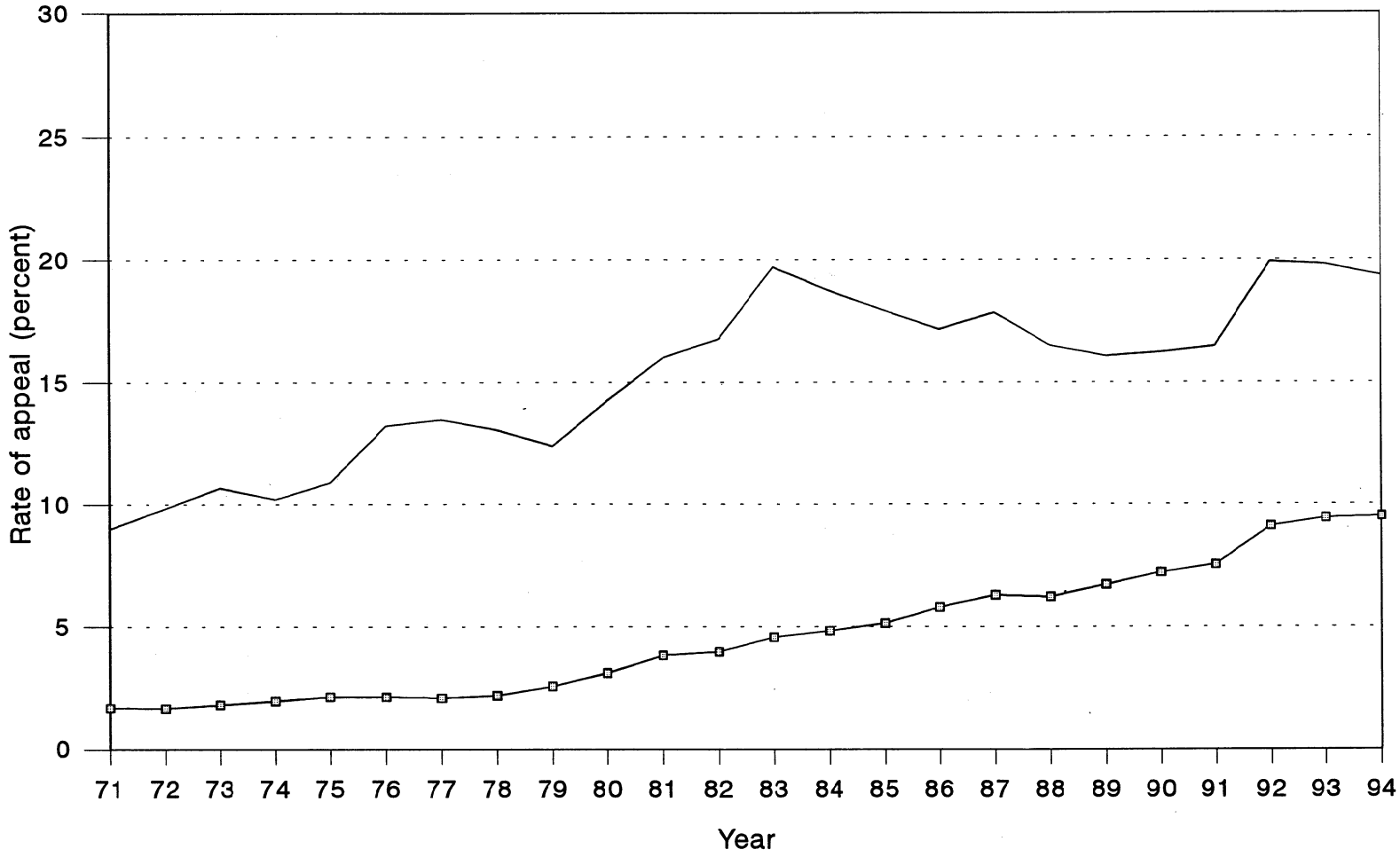
The second trend relates to the decisions received by claimants and employers as a proportion of the appeals that they file (the success rate). Currently, employers win a slightly higher percentage of the lower and higher authority appeals that they file than the percentage of appeals won by claimant appellants. Employer appellants, however, have been receiving a smaller percentage of favorable decisions at both the lower and higher appeals levels between 1971 and 1994, while claimant appellants have been receiving a larger percentage (see Figures 9 and 10). Thus, the gap between appellant success rates for employers and claimants at both

FIGURE 6. Total Lower Authority Appeals by Issue, 1971-1994



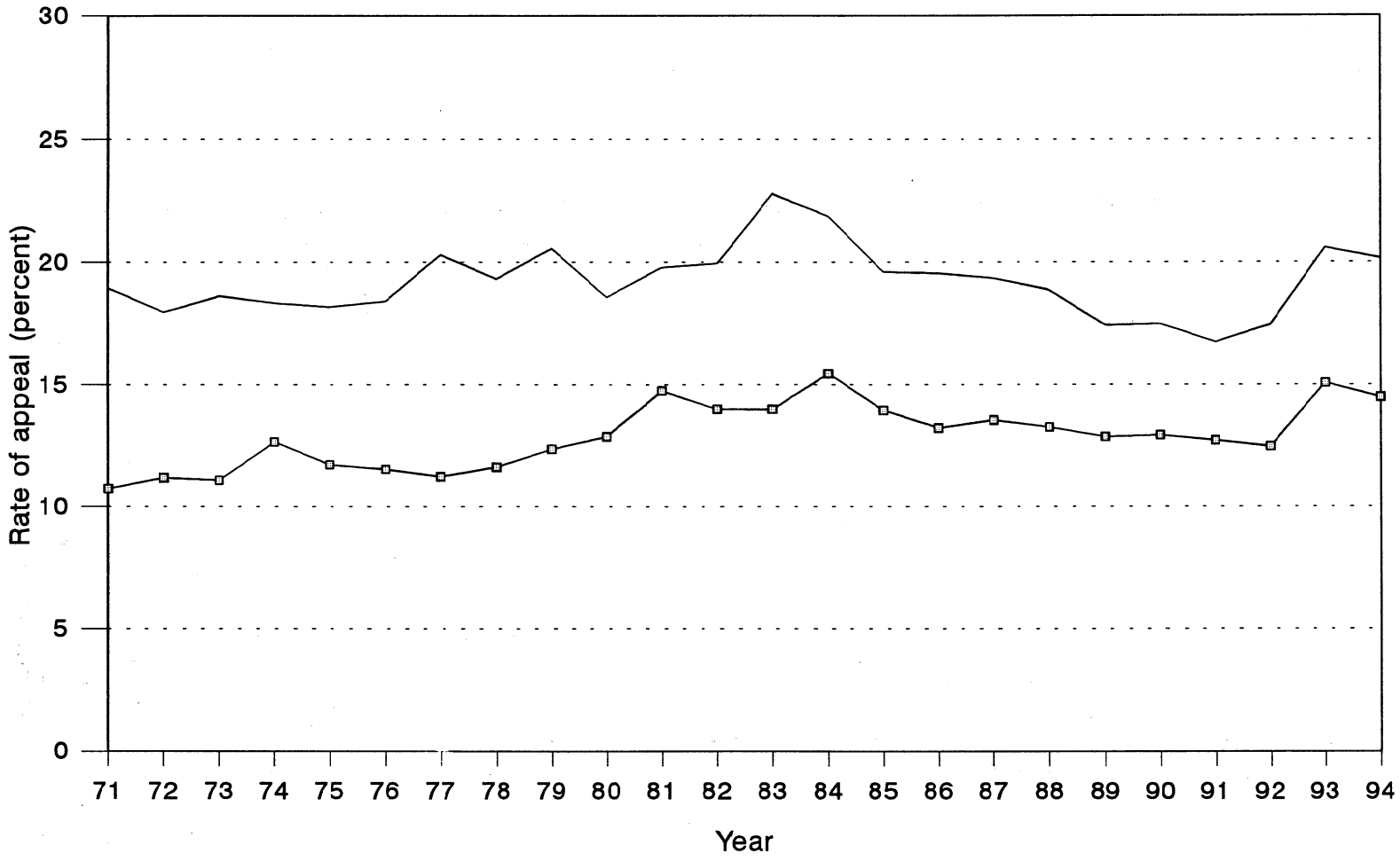
SOURCE: Unemployment Insurance Required Reports.

FIGURE 7. Claimant and Employer Rates of Lower Authority Appeal, 1971-1994



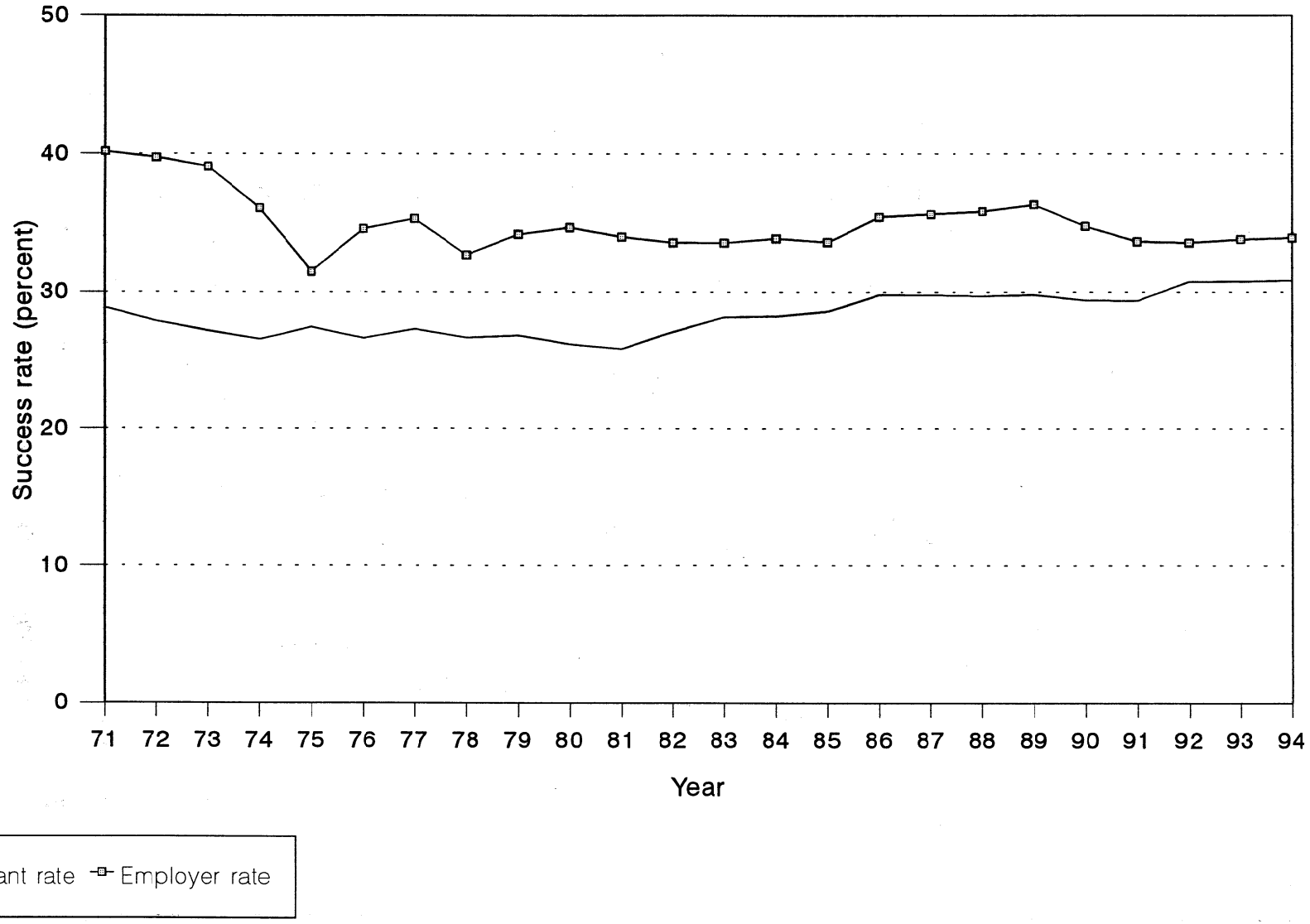
NOTE: Lower authority appeals rate is the percentage of unfavorable decisions received by the claimant (employer) that the claimant (employer) appealed.
SOURCE: Unemployment Insurance Required Reports.

FIGURE 8. Claimant and Employer Rates of Higher Authority Appeal, 1971-1994



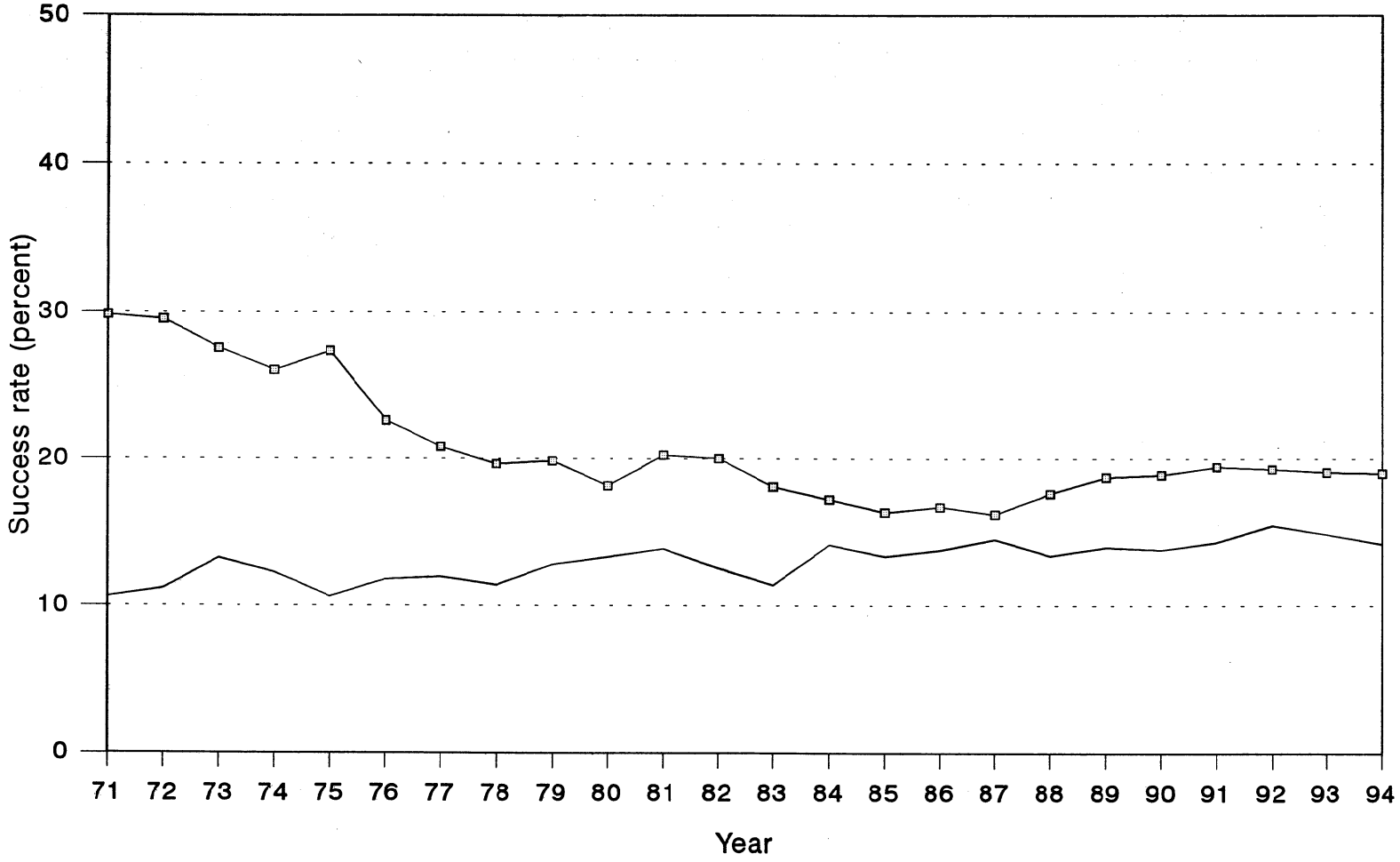
NOTE: Higher authority appeals rate is the percentage of unfavorable lower authority decisions received by the claimant (employer) that the claimant (employer) appealed.
SOURCE: Unemployment Insurance Required Reports.

FIGURE 9. Claimant and Employer Lower Authority Appeal Success Rates, 1971-1994



NOTE: Success rate is the percentage of lower authority appeals filed by the claimant (employer) that the claimant (employer) won.
SOURCE: Unemployment Insurance Recuired Reports.

FIGURE 10. Claimant and Employer Higher Authority Appeal Success Rates, 1971-1994



NOTE: Success rate is the percentage of higher authority appeals filed by the claimant (employer) that the claimant (employer) won.
SOURCE: Unemployment Insurance Required Reports.

appeals levels has declined substantially, and is converging around 32 percent for appellants in lower authority appeals and 18 percent in higher authority appeals. Thus, the success rates of employer appellants are falling at both the lower and higher appeals levels, while at the lower level, their appeals rates are increasing.

Summary

Between 1971 and 1994 the number of both lower and higher authority appeals have increased. Lower authority appeals as a percentage of both initial claims and denials have also increased. Furthermore, within lower authority appeals, separation appeals as a percentage of separation denials and nonseparation appeals as a percentage of nonseparation denials have both increased. In particular, appeals of misconduct issues have increased substantially, while appeals of voluntary quit, refusal of suitable work, and able and available for work issues have decreased.

The overall number of appeals filed by claimants is higher than the number filed by employers. Employers, however, have been appealing at an increasing rate over time. The success rate of employers in winning the appeals that they file has decreased at both lower and higher authorities, while the success rate of claimants who are appellants has increased. Both employers and claimants who file appeals are now winning about 32 percent of the lower authority appeals and about 18 percent of the higher authority appeals.

EXPLAINING DENIAL RATES, APPEAL RATES, AND APPEAL OUTCOMES

In order to understand the trends in denial rates, appeal rates, and appeal outcomes over time and across states, the authors conducted empirical research on these issues. This section discusses the empirical analyses using state data from 1978 to 1990. The following variables were selected to describe the denial rates, appeal rates, and appeal outcomes: state tax collections, trust fund solvency, the efficiency of state administration, UI benefit generosity, labor force characteristics, and penalties associated with nonmonetary eligibility requirements. The next section presents the empirical research in appeal rates and success rates for both employers and claimants using micro-level data on appeals in Wisconsin and Texas.

Factors Influencing Denial Rates, Appeal Rates, and Appeal Outcomes

A number of factors which may influence the denial rates and appeal rates were included in the research.[21] The factors are grouped into three categories: policy variables, benefit variables, and labor force characteristics. Each of these is discussed below.

Policy Variables

A number of policy variables were considered in the analysis, including those in the following general categories: state solvency, nonmonetary eligibility rules, and state administration.

Solvency Variables. Three variables were used to measure the impact of state solvency on denial and appeal rates. Two of these variables measure a state's current ability to raise taxes—the effective employer tax rate as a percentage of taxable wages and the state taxable wage base (as measured by the difference between the state taxable wage base and the required federal taxable wage base). A third factor, the reserve ratio (net reserves as a share of total covered wages), was used to measure the health of the state UI trust fund.[22]

Lower state tax collections (as described by the combined effect of the tax rate and tax base) would be expected to result in higher rates of denial (and consequently appeal). Similarly, the lower the reserve ratio, the higher the anticipated rate of denials and appeals. Denial rates and appeal rates would be expected to be higher when states are facing solvency problems, presumably because fiscal factors can create pressures to deny benefits and to establish (legislatively or administratively) more restrictive eligibility rules.

Nonmonetary Eligibility Rules. Three variables were used to measure the severity of the penalty imposed for nonmonetary eligibility disqualification. State law regarding the length of time an eligibility disqualification is imposed (either for the entire spell of unemployment or for a shorter period of weeks) was used for the issues of voluntary leaving, discharge due to misconduct, and refusal of suitable work.[23] As noted in ACUC (1995), a number of states have increased the severity of their penalty in these areas between 1978 and the present.[24] For each issue, a more severe penalty (i.e., a durational disqualification) could result in increased denials (provided that states are able to detect the eligibility problems which may result in a determination of ineligibility).[25] On the other hand, a more severe penalty may discourage potential claimants

from filing for benefits, thereby reducing the denial rate. Similarly, the relationship between these nonmonetary eligibility measures and appeal rates is difficult to predict a priori.

Measures of State Administration. Four variables were used to measure state administration. The quality and timeliness with which nonmonetary determinations are decided should affect the rates at which employers and claimants appeal decisions. If employers or claimants perceive that the state is doing a poor job in administering UI claims, then they may be more likely to appeal eligibility decisions made by the state. The extent to which Democrats are in control of the state legislature and the governor's office is also included in the model. This variable might serve as a proxy for measuring the state UI administration's attitude toward individuals applying for UI benefits. Presumably, a more Democratic state government could bring a more claimant-oriented perspective to the administration of the program, and a more Republican state government could bring a more employer-oriented perspective. Finally, when predicting appeal rates, the denial rate is also included to control for differences in the percentage of claimants for whom an appeal is an option and when predicting appeal outcomes, information on denial rates and the rate at which employers file appeals are used to control for these program differences across states.

Generosity of Benefits

Two measures of benefit generosity—actual duration of benefits and the ratio of average weekly benefit amount to state average weekly wage—were included in the analysis.[26] The more generous that benefits are perceived to be, the more attractive the UI program appears to potential claimants. Thus, more generous benefits would be expected to result in higher denial rates, since more claimants are enticed to apply. Similarly, claimant and employer appeal rates would be expected to be higher when benefits are more generous because of an increased application rate for UI benefits and an increased desire on the part of claimants to receive benefits.

Labor Force Characteristics

Three variables were used to control for differences in the labor force across states and over time: total unemployment rate, the percentage of the unemployed who are job losers, and the

unionization rate. Higher unemployment rates and higher percentages of job losers occur during times of recession, when individuals are more likely to be laid-off, less likely to quit their jobs, and more likely to accept work. As a result, during periods of higher unemployment (and when a higher portion of the unemployed are job losers), there are likely to be fewer separation denials and fewer appeals. Higher rates of unionization are likely to be associated with fewer separation denials and appeals, since unions are often concentrated in industries which rely on temporary layoffs (e.g., construction, manufacturing) and unionized employees are more likely to be eligible for UI benefits than non-union employees.[27]

Discussion of Empirical Results

Data

The model was estimated using annual, state-level data from 1978 to 1990.[28] Data were excluded for the state of Nebraska, because denial rates are extremely high and the Unemployment Insurance Service indicated that there are problems with the data that Nebraska reports. Similarly, Puerto Rico and the Virgin Islands were also excluded from the analysis because of issues regarding data reliability. Table 5 displays the means for all the variables used.

Model Specification

Given the panel nature of the data (i.e., it contained multiple observations for each state over a given number of years), the model was estimated using generalized least squares regression (GLS).[29] The remainder of this section presents the results from the GLS regressions, as well as geographic maps of the denial rates and changes in denial rates over time. Only those results which are statistically significant (as indicated by asterisks in the tables) are discussed below.

Results for Separation and Nonseparation Denial Rates

The denial rate results from the GLS regression are presented in Table 6. Different equations were calculated for separation issues (raised by an employer regarding a claimant's separation from work) and nonseparation issues (raised by a state agency regarding a claimant's ongoing eligibility for UI benefits). The model had higher explanatory power for differences across states and time for separation issues (45 percent of variation was explained) than for

Table 5. Means and Standard Deviations of Variables from Regressions, All States, 1978-1990

Variables:	Means	Standard Deviations
Dependent Variables:		
Denial Rate	0.211	0.099
Separation Denial Rate	0.093	0.046
Nonseparation Denial Rate	0.153	0.098
Employer Appeal Rate	0.010	0.008
Claimant Appeal Rate	0.036	0.018
Employer Success Rate	0.360	0.147
Claimaint Success Rate	0.280	0.071
Explanatory Variables:		
Effective Tax Rate	0.025	0.010
State Tax Base Over Federal Level	1,678	2,640
Reserve Ratio (lagged 3 years)	1.09	1.04
Disqualification for Voluntary Quit	0.90	0.30
Disqualification for Refusing Work	0.69	0.46
Disqualification for Misconduct	0.71	0.45
State Government	2.02	0.97
Performance of Nonmonetary Determination	0.82	0.19
Timeliness of Nonmonetary Determinations	0.75	0.17
Actual Benefit Duration	13.6	2.7
Benefit Amount/Wages	0.37	0.05
Total Unemployment Rate	0.068	0.023
Percent Labor Force Unionized	0.17	0.07
Job Losers as Percent of Unemployed	0.48	0.08
Percent Appeals Filed by Employers	0.199	0.097

NOTE: Data is for 1978 to 1990 and includes all states except Nebraska.
SOURCE: Authors' calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

Table 6. Regression Results for Separation and Nonseparation Denials, All States, 1978-1990

Explanatory Variables:	Separation Denial Rate/ Initial Claim	Nonseparation Denial Rate/ Claimant Contact
Effective Tax Rate	-2.777***	-3.535***
State Tax Base Over Federal Level	0.000003***	0.000008***
Reserve Ratio (lagged 3 years)	-0.007***	-0.005
Disqualification for Voluntary Quit	-0.043***	—
Disqualification for Refusing Work	—	-0.004
Disqualification for Misconduct	-0.025***	—
State Government	0.0007	-0.030***
Performance of Nonmonetary Determination	—	—
Timeliness of Nonmonetary Determinations	—	—
Denial Rate per Initial Claim	—	—
Actual Benefit Duration	0.004***	-0.005***
Benefit Amount/Wages	-0.034	0.162**
Total Unemployment Rate	-0.057	-0.0004
Percent Labor Force Unionized	-0.192***	-0.080
Job Losers as Percent of Unemployed	-0.152***	-0.072
1979	-0.007***	-0.033**
1980	-0.026***	-0.047***
1981	-0.025***	-0.050***
1982	-0.034***	-0.070***
1983	-0.033***	-0.041*
1984	-0.024***	-0.030
1985	-0.033***	-0.033*
1986	-0.040***	-0.032
1987	-0.037***	-0.031
1988	-0.031***	-0.034*
1989	-0.030***	-0.033
1990	-0.033***	-0.040*
R^2 Statistic	.45	.25

NOTES: Data is for 1978 to 1990 and includes all states except Nebraska.
A GLS model was used to estimate the equations.
One asterisk (*) indicates data are significant at 0.05 to 0.10 level.
Two asterisks (**) indicate data are significant at the 0.01 to 0.05 level.
Three asterisks (***) indicate data are significant at less than 0.01.

SOURCE: Authors' calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

nonseparation issues (25 percent of variation was explained). These results indicate that high separation denial rates are associated with the following: (1) lower state UI tax rates, (2) lower reserve ratios, (3) nonmonetary eligibility penalties for separation issues which disqualify individuals for less than the full duration of unemployment (i.e., more lenient penalties on issues of voluntary quits and misconduct),[30] (4) longer durations of UI benefits, and (5) lower percentages of unionization and job losers.[31] These results indicate that high nonseparation denial rates are associated with the following: (1) lower state UI tax rates, (2) more Republican state government, (3) more generous weekly UI benefit amounts, and (4) shorter length of UI benefits.[32] Thus, there are some differences in the factors that influence separation and nonseparation issues. Reserve ratios, nonmonetary eligibility penalties, unionization rates, and job loser rates affect separation issues but not nonseparation issues; while control of the state government seems to only affect nonseparation issues. These results indicate that states impose somewhat stricter eligibility criteria if their UI tax collections are low, consequently denying benefits to a larger portion of claimants.

There is a large amount of state variation in denial rates, however, that could not be captured by the policy variables in the models discussed above.[33] An examination of the patterns of denial rates across the United States finds geographic clusters of high and low denial rates. Figure 11 maps the average separation denial rate between 1978 and 1990, and Figure 12 maps the nonseparation denial rate between 1978 and 1990. These maps indicate that states' denial rates display distinct geographical patterns. For example, Figure 12 displays a group of contiguous states in the east that have particularly low nonseparation denial rates, and a large group of states in the west which have high nonseparation denial rates. These patterns could be the result of many factors, including state cooperation or state competition, either of which may prompt neighboring states to adopt similar state laws or similar state administrative procedures, particularly with regard to eligibility.

Results for Employer Appeal Rate

In these equations, the employer (claimant) appeal rate is defined as the number of appeals brought by employers (claimants) as a percentage of all initial claims. The employer appeal rate results from the GLS regression are presented in the first column of Table 7. These results indicate that high employer appeal rates are associated with the following: (1) lower state UI

Figure 11. Separation Denial Rate, 1978–1990

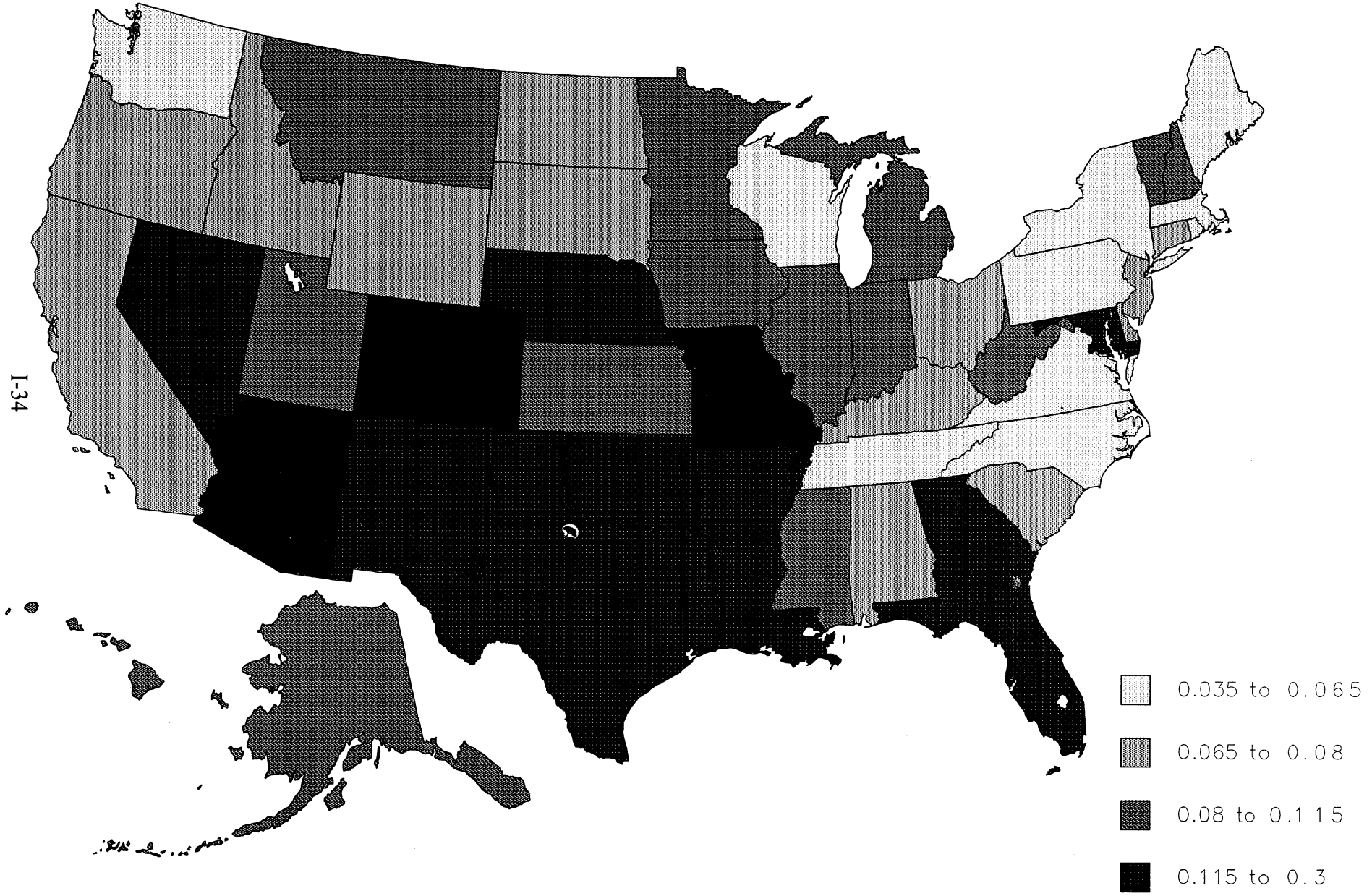
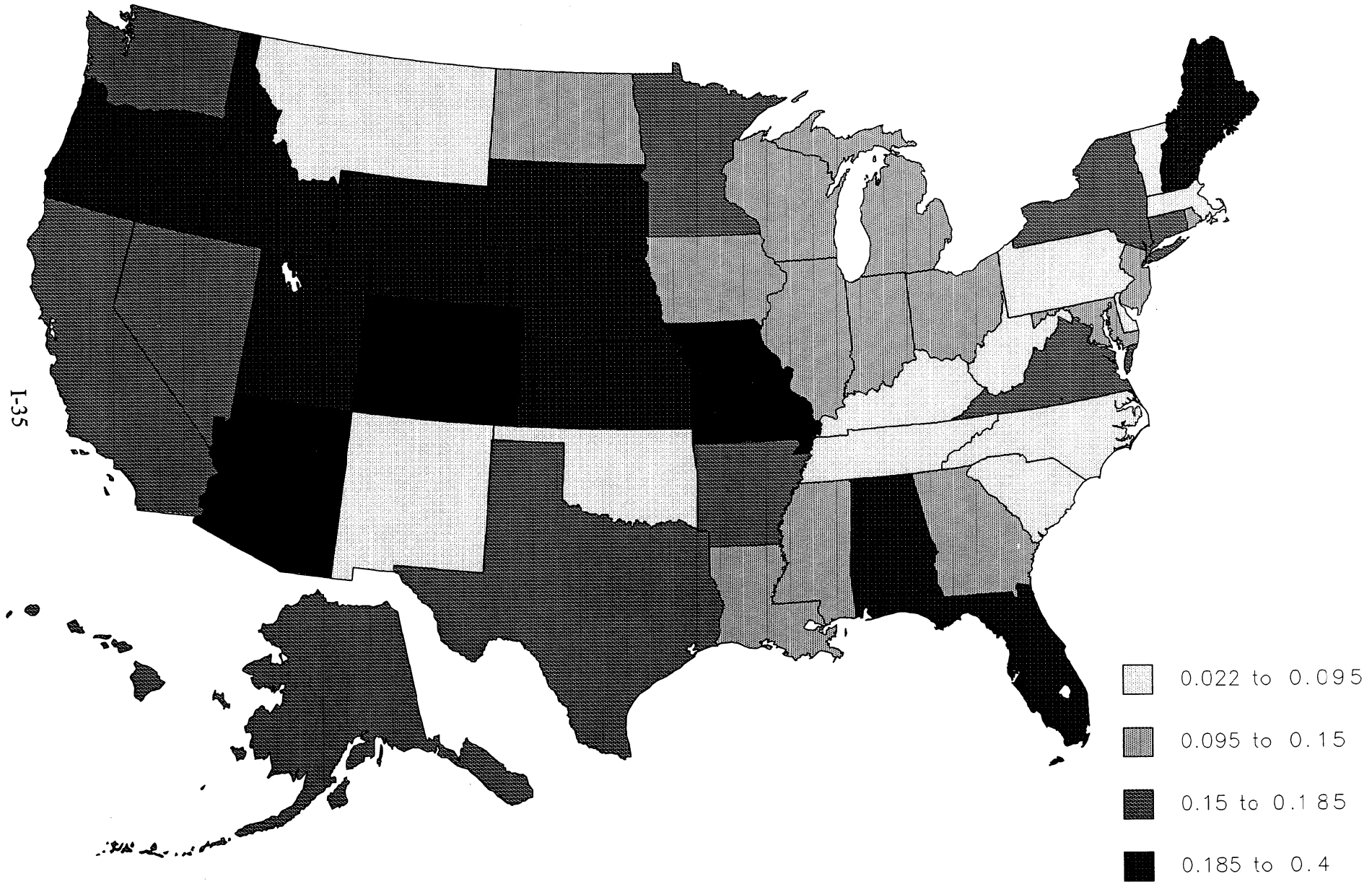


Figure 12. Nonseparation Denial Rate, 1978–1990



tax collections, (2) lower reserve ratios, (3) more lenient penalties for voluntary quit issues and more stringent penalties for misconduct discharges, (4) more generous UI benefits, (5) more Democratic state government, (6) slower processing of determinations for nonmonetary eligibility, and (7) lower rates of unionization.

In addition to these variables, year variables were also included.[34] Overall, for the time period analyzed (1978 to 1990), there was a slight increase over time in the regression coefficients for the year variables. This indicates that employer appeals are increasing over time, even after controlling for the above factors. The exact cause of this temporal increase remains unknown. It could simply reflect general increases in litigation across the country during this period, or employers' increasing reliance on third-party companies to manage UI activities.[35]

Results for Claimant Appeal Rate

The claimant appeal rate results from the GLS regression are presented in the second column of Table 7. These results indicate that high claimant appeal rates are associated with the following: (1) lower state UI tax collections, (2) lower reserve ratios, (3) more stringent penalties for misconduct, (4) more generous UI benefits, and (5) a lower rate of unionization and percentage of job losers.

In contrast to the employer appeal rates, the trend in the regression coefficients for the year variables in the claimant appeal equations was less pronounced and less consistent.

Results for Employer Success Rate

In these equations, success rate is defined as the number of appeals employers (claimants) win as a percentage of all appeals brought by employers (claimants). The employer success rate results from the GLS regression are presented in the first column of Table 8. This model had very high predictive power—88 percent of the variation in employer success rates was explained by the model. These results indicate that high employer success rates are associated with the following: (1) lower effective tax rates, (2) lower reserve ratios, (3) more lenient penalties for misconduct issues, (4) low denial rates, (5) shorter benefit durations, (6) higher total unemployment rates, (7) lower rates of unionization, and (8) lower rates of employer appeals. These results suggest that when states have with solvency problems (i.e., low reserves or lower

Table 7. Regression Results for Employer and Claimant Appeals, All States, 1978-1990

Explanatory Variables:	Employer Appeal Rate/ Initial Claim	Claimant Appeal Rate/ Initial Claim
Effective Tax Rate	-0.162***	-0.306***
State Tax Base Over Federal Level	-0.0000003*	-0.000001***
Reserve Ratio (lagged 3 years)	-0.002***	-0.002***
Disqualification for Voluntary Quit	-0.003***	-0.0004
Disqualification for Refusing Work	—	-0.001
Disqualification for Misconduct	0.002***	0.003**
State Government	0.001***	0.0005
Performance of Nonmonetary Determination	-0.0003	-0.003
Timeliness of Nonmonetary Determinations	-0.005***	0.0002
Denial Rate per Initial Claim	0.029***	0.098***
Actual Benefit Duration	0.001***	0.002***
Benefit Amount/Wages	0.017***	0.023**
Total Unemployment Rate	-0.018	-0.019
Percent Labor Force Unionized	-0.026***	-0.052***
Job Losers as Percent of Unemployed	0.001	-0.033***
1979	0.002*	0.003
1980	0.001	0.002
1981	0.003**	0.006***
1982	0.003*	0.004
1983	0.003*	0.006**
1984	0.006***	0.009***
1985	0.005***	0.006**
1986	0.004***	0.003
1987	0.005***	0.005*
1988	0.006***	0.005*
1989	0.006***	0.004
1990	0.006***	0.004
R^2 Statistic	.43	.57

NOTES: Data is for 1978 to 1990 and includes all states except Nebraska.
A GLS model was used to estimate the equations.
One asterisk (*) indicates data are significant at 0.05 to 0.10 level.
Two asterisks (**) indicate data are significant at the 0.01 to 0.05 level.
Three asterisks (***) indicate data are significant at less than 0.01.

SOURCE: Authors' calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

Table 8. Regression Results for Lower Authority Appeal Success, All States, 1978-1990

Explanatory Variables:	Lower Authority Appeal Success Rate	
	Employer	Claimant
Effective Tax Rate	-4.409**	-1.053
State Tax Base Over Federal Level	0.000005	0.0000005
Reserve Ratio (lagged 3 years)	-0.020***	0.002
Disqualification for Voluntary Quit	-0.025	-0.029***
Disqualification for Refusing Work	—	0.006
Disqualification for Misconduct	-0.028*	-0.035***
State Government	-0.006	-0.004
Performance of Nonmonetary Determination	-0.029	-0.006
Timeliness of Nonmonetary Determinations	-0.018	-0.005
Denial Rate per Initial Claim	-0.260***	0.143***
Actual Benefit Duration	-0.007**	0.002**
Benefit Amount/Wages	-0.129	0.264***
Total Unemployment Rate	1.140***	0.117
Percent Labor Force Unionized	-0.397***	0.023
Job Losers as Percent of Unemployed	-0.021	0.081*
Percent of Appeals Filed by Employers	-0.152**	-0.067**
1979	-0.037	-0.002
1980	0.002	-0.005
1981	-0.005	-0.013
1982	-0.065*	-0.011
1983	-0.044	-0.002
1984	-0.041	0.015
1985	-0.052	0.022
1986	-0.047	0.022
1987	-0.033	0.023
1988	-0.033	0.024*
1989	-0.015	0.025*
1990	-0.040	0.018
R^2 Statistic	.88	.18

NOTES: Success rate is defined as percent of appeals won by party who appealled.
Data is for 1978 to 1990 and includes all states except Nebraska.
A GLS model was used to estimate the equations.
One asterisk (*) indicates data are significant at 0.05 to 0.10 level.
Two asterisks (**) indicate data are significant at the 0.01 to 0.05 level.
Three asterisks (***) indicate data are significant at less than 0.01.

SOURCE: Authors' calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

tax collections), employers are more likely to win their appeals at the lower authority. In addition, although actual employer success rates have been decreasing over time, the model's explanatory variables appear to capture this trend because the year variables do not reflect any pattern.

Results for Claimant Success Rate

The claimant success rate results from the GLS regression are presented in the second column of Table 8. This model, however, had very low predictive power—only 18 percent of the variation in claimant success rates was explained by the model. These results indicate that high claimant success rates are associated with the following: (1) more lenient penalty for misconduct issues, (2) higher denial rates, (3) more generous program benefits, (4) higher percentage of job losers as a percent of the unemployed, and (5) lower rates of employer appeals. While the explanatory power of the model was low, most of the significant variables were anticipated. Although the variable reflecting the political party of the state was not significant, claimants are more likely to win the appeals they file in states with more generous UI programs (i.e., longer durations of benefits, higher benefit amounts, and more lenient nonmonetary eligibility penalties).

TAKING A CLOSE-UP LOOK AT APPEALS: INFORMATION FROM TWO STATES

There are two primary questions that can be answered with appeal-level data. These are (1) whether or not the current structure which finances UI benefits encourages employers to appeal legitimate cases and (2) what factors predict which party will win an appeal. This section provides background information on these two issues, and provides the results from 1994 appeal-level data in Wisconsin and Texas.

Theoretical Effect of Experience Rating On Appeal Rates and Success Rates

In most states, UI benefits are financed exclusively through employer payroll taxes that are assessed by the state.[36] States are currently required by the Federal Unemployment Tax Act to finance program benefits through an "experience-rated" tax structure. Under experience rating, the rate of taxation for a given tax schedule[37] varies with an individual employer's unemployment experience. In other words, employers who create the most cost for the system are assessed the

highest tax rates.[38] It is often argued that experience-rated taxes allow state and federal governments to influence employers' behavior in socially beneficial ways. Economists, however, often assert that the entity on which a tax is legislatively imposed (in this instance, employers) may be different from the entity which actually pays the tax.[39]

Recent research by Anderson and Meyer (1994), which focused specifically on the experience-rated UI tax that firms pay, indicates that firms are able to shift flat taxes (e.g., the minimum tax rate within that firm's industry) to their employees, but are much less able to shift the portion of their taxes that are experience-rated. Thus, a significant percentage of experience-rated taxes are absorbed by the individual firm.

As a result, an experience-rated UI tax (rather than a flat tax) is likely to promote UI program goals by affecting a firm's decision-making. One such program goal is to provide a financial incentive for employers to police the UI program by protesting ineligible claims for UI benefits and to participate in the state legislative process.[40] This program goal, however, may result in negative consequences, depending on the extent to which it is realized. For example, experience rating may result in inappropriate employer involvement in the eligibility determinations and appeals processes if some employers respond to these financial incentives by contesting legitimate UI claims.

Since their UI taxes are directly related to the extent to which their former employees receive UI benefits, employers have an incentive to contest UI claims. In 1994, employers were responsible for 26 percent of lower authority appeals (approximately 256,000 employer appeals); the rate of employer appeals has grown more rapidly than that for claimant appeals.

It is difficult to determine the extent to which employers respond to existing incentives by appealing even those UI claims that are legitimate. The Office of the Inspector General (1985) found that employers who pay the maximum possible tax rate in each state file appeals at about half the rate of employers whose tax rates increase when their benefit costs increase. This may reflect the reduced incentive for employers at the maximum tax rate to contest UI claims, since they face no additional cost associated with each additional layoff.[41]

Effect of Experience Rating on Appeal Rates and Success Rates in Texas and Wisconsin

Data From Wisconsin and Texas

Using micro-level data from Wisconsin and Texas in 1994, the authors were able to obtain information on employer tax rates and use of representation (in Wisconsin only).[42] The Wisconsin data included all lower level appeals resulting from a nonmonetary separation issue in 1994 (11,746 hearings). The data from Texas was a random sample of 20 percent of all experience-rated employers in 1994, which was merged with the corresponding lower level appeals data for nonmonetary separation issues (3,561 hearings).

Appeal Rates

The data from Wisconsin and Texas can be used to analyze whether employers in these two states are excessively appealing legitimate UI claims. The Wisconsin and Texas data confirm the Office of the Inspector General's results that employers at the maximum tax rate are less likely to file appeals than employers at other tax rates. In Wisconsin, employers brought 19 percent of all appeals involving employers at the maximum tax rate, and 31 percent of all appeals involving employers at a tax rate other than the maximum. In Texas, employers brought 45 percent of all appeals involving employers at the maximum tax rate, and 55 percent of all appeals involving employers at a tax rate other than the maximum (see Table 9.) This finding does not necessarily indicate that employers are making *excessive* use of the appeals system. Such a conclusion might be valid, however, if there were evidence that employers' (or claimants') win rates vary systematically with an employers' level of experience rating.

Success Rates

Tabulations of the data from Texas and Wisconsin do not provide evidence that employer success rates (i.e., the number of appeals won by employers as a percentage of all appeals brought by employers) vary with experience rating. Of the appeals filed by employers in Wisconsin, employers won 28 percent of the appeals at the maximum tax rate and 26 percent of the appeals at all other tax rates. Of the appeals filed by employers in Texas, employers won 14 percent of the appeals at the maximum tax rate and 14 percent of the appeals at all other tax rates (see Table 9.) This preliminary analysis of win rates by the level of experience rating does not indicate that employers are making excessive use of the appeals system.

Table 9. Employer Appeal Rate and Success Rate by Tax Rate, Wisconsin and Texas

Tax Rate	Wisconsin Data		Texas Data	
	Appeal Rate	Success Rate	Appeal Rate	Success Rate
Less than Maximum	31%	26%	55%	14%
Maximum Rate	19%	28%	45%	14%

NOTE: Employer success rate is when employer files an appeal, not when claimant files an appeal.

SOURCES: Authors' calculations using data provided by Unemployment Compensation; Department of Industry, Labor, and Human Resources; State of Wisconsin; and Texas Employment Commission.

It is important to note that at least two primary factors influence the outcome of an appeal—which parties participated in the hearing and which, if any, parties were represented (legal or nonlegal). The regression results for Wisconsin presented later in this paper provide additional information on how tax rates influence employers' success rates, when important variables such as participation and representation are included. This more sophisticated analysis of employer win rates indicates that employer win rates do not vary significantly with the experience-rated tax rate.

Finally, one might conclude that employers were making excessive use of the appeals system if they won a substantially lower percentage of the appeals that they filed compared to the percentage of appeals won by claimants who file them. There is no evidence that this is the case on a national level. In 1993, nationwide, employers won 34 percent of the appeals that they filed and claimants won 31 percent of the appeals that they filed.

By state, however, the evidence varies. In Wisconsin during 1994, employers won 28 percent of the appeals that they filed and claimants won 29 percent of the appeals they filed. In Texas, employers won 14 percent of the appeals that they filed and claimants won 67 percent of the appeals they filed. Texas employers filed a disproportionately higher share of appeals (55 percent compared to a national average of 26 percent) and claimants won a disproportionately higher share of appeals (78 percent compared to a national average of 31 percent). Overall, this evidence indicates that employers may be excessively appealing in Texas.

Factors Influencing Appeals Outcomes

Little research has been devoted to understanding the UI appeals process and the factors which affect the probability that either the employer or claimant wins. This section discusses two relevant factors that contribute to how well each side is able to present its case. First, it is important for both parties to participate in the hearing. The importance of participation, however, depends on which separation issue is in question. The burden of proof is placed on employers for misconduct issues and on claimants for voluntary quit issues. Thus, if an employer did not show up for a misconduct issue, the claimant would most likely win. If an employer did not show up for a voluntary quit issue related to good cause, however, the verdict would depend on whether the claimant could prove he or she had good cause for leaving.

In both Texas and Wisconsin, claimants are more likely than employers to participate in lower level appeals. In Texas, claimants participated (including over the phone) in 66 percent of the hearings and employers participated in only 16 percent of the hearings. In Wisconsin, claimants participated (including over the phone) in 70 percent of the hearings and employers participated in 59 percent of the hearings. As expected, participation in the hearing increases the party's likelihood of winning when the other party does not participate. Table 10 displays these results.

A second factor which increases the likelihood that one side will win is the use of representation (legal or nonlegal). Professor Herbert Kritzer recently conducted a process analysis of lower authority appeals hearings in Wisconsin.[43] He found that representation in general can contribute significantly to UI appeals hearings. Representatives often perform one or more of the following functions: (1) prepare their client for the UI hearing, (2) help frame the issue being appealed in a manner that best serves their client, (3) ensure that necessary witnesses and documentation are brought to the hearing, and (4) ask relevant questions of the parties and their witnesses. In most states, representation of claimants and employers can be either legal or nonlegal advocates. There are, however, some differences between the type of representatives claimants are likely to use and those employers are likely to use.

Kritzer notes that claimant representatives are often either union officials, law students, or lawyers. Because the fees that attorneys earn when representing claimants in UI cases are limited in most states (including Wisconsin), lawyers represent claimants infrequently and often only when the case is connected in some way to another proceeding (e.g., allegation of harassment or discrimination). In contrast, union officials usually represent claimants as part of their union duties and law students usually represent claimants as volunteers.

Because of the low fees that attorneys can charge and the limited availability of most "voluntary" claimant representatives, claimants may be more likely to have representation when they have a strong case. Thus, it is possible that some portion of claimants with representation are more likely to win their cases because of the advocate selection process, rather than the actual contribution the advocates make to the hearing process.

In general, employers are likely to be more familiar than claimants with the unemployment compensation appeals process. Employers frequently are represented by either someone from inside the firm or an agent outside the firm; this representative may be an

Table 10. Success Rate by Appearance, Wisconsin and Texas

	Just Claimant	Just Employer	Both Parties	Neither Party
Wisconsin				
Percent Appearing	53%	3%	13%	32%
Claimant Success Rate	43%	1%	33%	2%
Employer Success Rate	23%	59%	33%	30%
Texas				
Percent Appearing	20%	9%	50%	21%
Claimant Success Rate	87%	N.A.	73%	N.A.
Employer Success Rate	4%	46%	12%	2%

NOTE: N.A. indicates the information is not available because sample sizes were too small to estimate.

SOURCE: Authors' calculations using data provided by Unemployment Compensation; Department of Industry, Labor, and Human Resources; State of Wisconsin; and Texas Employment Commission.

attorney or a nonlegal advocate. Larger firms are more likely to have either internal legal staff or human resources personnel who are very familiar with the UI appeals system. Many firms also rely on third party employer representatives—agents who specialize in monitoring and controlling firms' payroll costs, including costs associated with workers' compensation and unemployment compensation. Part of the responsibility of third party representatives is to file appeals and represent firms at the actual hearings. As a result of the use of third-party representatives and because of the unrestricted fees that lawyers can charge employers (unlike claimants), employers are more likely than claimants to have access to representation in UI hearings. Additionally, firms that are either (1) large, (2) have in-house experience with UI hearings, or (3) contract with third-party representatives are more likely to bring a representative because of their easy access to these resources.

As a result of his observations of UI hearings in Wisconsin, Kritzer suggests that attorneys are not necessarily the most effective representatives in UI hearings for either claimants or employers. He finds that the most effective advocates are those that are most familiar with UI hearings procedures. Effective legal representatives, therefore, typically specialize in employment law and appear at UI hearings as a practice. Effective nonlegal representatives are generally very knowledgeable about specific UI rules, regulations, and procedures and also specialize in providing representation at UI hearings.

In the appeals data that the authors used for this analysis, representation information was only available for Wisconsin. In 1994 in Wisconsin, parties were represented in only 6 percent of all appeals. When one party was represented, the party increased their chances of winning the appeal. In addition, claimants were helped slightly more than employers when they were represented (see Table 11). The section below discusses a more sophisticated analysis using the Wisconsin data to determine how various factors that influence the outcome of an appeals hearing.

Discussion of Empirical Results

Variables Used in the Analysis

Using the appeals data from Wisconsin, two categories of factors were analyzed to determine their influence on the success rates of claimants and employers.[44] These categories include

Table 11. Success Rate by Representation, Wisconsin

Success Rate	Just Claimant Represented (2.2%)	Just Employer Represented (3.4%)	Both Parties Represented (0.4%)	Neither Parties Represented (94.1%)
Claimant	55%	24%	46%	28%
Employer	25%	41%	N.A.	28%

NOTE: N.A. indicates the information is not available because sample sizes were too small to estimate.

SOURCE: Authors' calculations using data provided by Unemployment Compensation; Department of Industry, Labor, and Human Resources; State of Wisconsin.

variables describing characteristics of the employer and variables describing characteristics of the appeal hearing. Table 12 displays the means for all variables used.

Employer Characteristics. Three variables were used to describe characteristics of the employer. The first measured the size of the firm, and was broken into four groups: firms with less than 20 employees, firms with between 20 and 99 employees, firms with between 100 and 499 employees, and firms with 500 or more employees. It is anticipated that larger employers are more likely to win a hearing since they have more resources to devote to managing unemployment compensation costs. The second variable measured the experience-rated tax of the employer.[45] The expected effects of employer tax rates on employer success rates have been discussed previously in this paper. A third measure of whether the employer was in the manufacturing industry was included to further describe the type of employer.

Characteristics of the Appeal Hearing. Six variables were used to describe characteristics of the hearing. The first two were whether the claimant appeared at the hearing and whether the employer appeared at the hearing. The second two were whether the claimant was represented at the hearing and whether the employer was represented at the hearing.[46] As discussed earlier, participation and representation are generally expected to increase the likelihood that the party wins. The fifth variable was whether the hearing involved consideration of multiple issues. Employers are more likely to win appeals involving multiple issues than are claimants because the issues that have been raised by the employer in these appeals are more complex and require more preparation and familiarity with UI laws and the appeals system. The final variable was whether the appeal hearing was conducted by telephone or in-person; the effect of this variable is difficult to predict.

Model Specification

Because the success rate variables that are being estimated are dichotomous (i.e., they equalled one if the claimant or employer won the appeal and zero if the claimant or employer did not win the appeal), the model was estimated using a logistic regression.[47] The results of these regressions are presented in Table 13. The numbers displayed in this table are the log odds associated with each variable. The log odds indicate the change in the likelihood of an event

Table 12. Means and Standard Deviations of Variables From Regressions, Wisconsin, 1994

	Means	Standard Deviations
Dependent Variables:		
Employer Received Favorable Decision*	0.58	0.49
Claimant Received Favorable Decision*	0.42	0.49
Explanatory Variables:		
Employer Size:		
Less Than 20 Employees	8	6
Between 20 and 99 Employees	51	23
Between 100 and 499 Employees	247	113
500 or More Employees	2203	2242
Tax Rate	2.31	1.95
Manufacturing Industry*	0.29	0.45
Employer Appears at Hearing*	0.16	0.36
Claimant Appears at Hearing*	0.65	0.48
Employer is Represented at Hearing*	0.03	0.16
Claimant is Represented at Hearing*	0.04	0.19
Multiple Issues Contested*	0.33	0.47
Telephone Hearing*	0.18	0.38

NOTES: Data are 11,746 lower authority appeal hearings from Wisconsin in 1994. The means of variables with an asterisk (*) are percentages of the total sample. For example, the mean value of 0.58 for the first dependent variable indicates that employers received a favorable decision in 58 percent of the appeals they brought.

SOURCE: Authors' calculations using data provided by Unemployment Compensation; Department of Industry, Labor, and Human Resources; State of Wisconsin.

Table 13. Regression Results for Employer and Claimant Success Rates, Wisconsin, 1994

	Received Favorable Decision	
Explanatory Variables:	Employers	Claimants
Employer Size:[1]		
Between 20 and 99 Employees	1.090	0.813***
Between 100 and 499 Employees	1.355***	0.845**
500 or More Employees	1.345***	0.742***
Tax Rate	0.986	1.046***
Manufacturing Industry	1.125	0.873***
Employer Appears at Hearing	2.027***	0.666***
Claimant Appears at Hearing	0.623***	30.143***
Employer is Represented at Hearing	1.698***	0.642***
Claimant is Represented at Hearing	0.872	2.288***
Multiple Issues Contested	0.769***	0.533***
Telephone Hearing	0.711***	0.678***
Percent Correctly Classified	72.17	71.84
Model Chi Square	117***	1906***

NOTES: Data are 11,746 lower authority appeals hearings from Wisconsin in 1994.
A logistic regression model was used to estimate the equations.
[1]The reference group is "Less Than 20 Employees."
One asterisk (*) indicates data are significant at 0.05 to 0.10 level.
Two asterisks (**) indicate data are significant at the 0.01 to 0.05 level.
Three asterisks (***) indicate data are significant at less than 0.01.

SOURCE: Authors' calculations using data provided by Unemployment Compensation; Department of Industry, Labor, and Human Resources; State of Wisconsin.

occurring (in this case whether the employer or claimant won the appeal) caused by each explanatory variable, holding all other factors constant. A log odds greater than one denotes an increase in the likelihood of the event, while a log odds less than one denotes a decrease in the likelihood of the event. For example, according to the results of the regressions in Table 13, an employer who appeared at a hearing was 2.027 times more likely to win the appeal than an employer who did not appear. In contrast, an employer was only 0.623 times (about two-thirds) as likely to win an appeal when the claimant appeared at the hearing than when the claimant did not appear. These results are discussed in the following sections.

Results for Employer Success Rate

The model for employers correctly predicted whether the employer would win or lose an appeal he brought in 72 percent of the cases and was statistically significant as indicated by the model chi square of 117.[48] These results indicate that employers were more likely to win their appeal when: (1) the firm had more than 100 employees, (2) the employer appeared at the hearing, and (3) the employer was represented at the hearing. Employers were less likely to win their appeal when: (1) the claimant appeared at the hearing, (2) multiple issues were contested, and (3) the hearing was conducted by telephone.

Results for Claimant Success Rate

The model for claimants correctly predicted whether the claimant would win or lose his appeal in 72 percent of the cases and was statistically significant as indicated by the model chi square of 1906.[49] These results indicate that claimants were more likely to win their appeal when: (1) the claimant appeared at the hearing, (2) the claimant was represented at the hearing, and (3) the employer was taxed at a higher rate. Claimants were less likely to win their appeal when: (1) the employer had 20 or more employees, (2) the employer appeared at the hearing, (3) the employer was represented at the hearing, (4) the employer was in the manufacturing industry, (5) multiple issues were contested, and (6) the hearing was conducted by telephone.

Both employers and claimants were less likely to win an appeal when there were multiple issues involved in the appeal and when the hearing was conducted by telephone instead of in-person. These factors, however, had more of a negative effect on claimants than on employers. Claimants were only about half (0.533) as likely to win an appeal when multiple issues were

involved, whereas employers were just over three-fourths (0.769) as likely to win, all else being equal. This difference was smaller for telephone hearings--claimants were only 0.68 times as likely to win the appeal, while employers were 0.71 times as likely to win.

ENDNOTES

1. See, for example, ACUC (1995).

2. Corson et al. (1986) is the source for the information on how nonmonetary determinations and denials are made.

3. For more information on nonmonetary eligibility definitions, see ACUC (1995, 101-123).

4. Section 303(a)(3).

5. The state UI agency may also be involved in an appeal.

6. This state information on filing time and hearing officers for lower and higher authority appeals was obtained from *UI Financial Data Handbook.*

7. Referees in Hawaii, Ohio, and Tennessee have up to 30 days to reconsider a decision; in Michigan, they have up to 10 days.

8. Hawaii, Nebraska, and the Virgin Islands do not provide a second administrative appeal. Appeals of lower authority decisions in these states are taken directly to the state courts for judicial review.

9. Except in Mississippi where the board is appointed by the Employment Security Commission, and in New Jersey where the board is appointed by Director of Employment Security.

10. According to the Unemployment Insurance Service, there are problems with the denial rates reported by Nebraska.

11. The "other" category accounted for the remaining 12 percent.

12. The denial rate per initial claim is the mathematical product of the determination rate per initial claim and the denials per determination.

13. According to the Unemployment Insurance Service, there are problems with the denial rates reported by Nebraska.

14. The "other" category accounted for the remaining 13 percent.

15. Data for this analysis were extracted from the Unemployment Insurance Required Reports (UIRR) database, which contains statistics provided by the states. The states report UI appeals information monthly by filing Report 5130. Other than the number of appeals filed each month, the 5130 reports information in terms of decisions made on higher and lower authority appeals. Therefore, to remain consistent, the analysis reported here uses decisions to approximate appeals.

Between 1971 and 1994, the percentage of lower authority appeals decided ranged from 83 percent to 100 percent, and was below 93 percent in only four of those years. The

percentage of higher authority appeals decided ranged from 84 percent to 100 percent, and was below 93 percent in only six of those years. Therefore, the number of decisions closely approximates the number of appeals, and is adequate to analyze trends in UI appeals.

16. In contrast to the increase of 15 percent in the number of initial claims, the number of denials has remained relatively constant between 1971 and 1994.

17. According to the Unemployment Insurance Service, there are problems with the denial rates reported by Nebraska. It is, however, possible for this ratio to exceed 100 percent because the denominator of the ratio does not include the number of weeks that UI benefits are claimed by active UI claimants. Therefore, exclusion of the weeks of claimant contacts from the denominator in Table 1 causes the denial rate to be overestimated. Measuring total denials as a proportion of initial claims, however, allows this ratio to be directly compared with the ratio of total appeals to initial claims.

18. Once again, misreporting of Nebraska data seem to make this figure artificially low.

19. Since the UIRR Report 5130 does not separate the "other" category by issue, changes over time in appeals decisions with respect to specific issues within this category cannot be determined.

20. The figures in this section include only lower and higher authority appeals involving claimants and employers. Appeals in which the UI agency was a party have been excluded. They represent an average of 0.1 percent of total lower authority appeals and 1 percent of higher authority appeals during the period 1971 to 1994.

21. Both denial rates and appeal rates are expressed as a percentage of initial claims.

22. This measure was lagged 3 years in the regression equation. The 3-year lag structure has the most statistically significant impact on the denial and appeal rates. Statistically, the lag structure reflects the notion that it takes a few years for state policy decisions prompted by the status of the trust fund balance to affect a state's law or a state's administration of the program.

23. Since refusal of suitable work is not a factor in determining initial eligibility, it is not included in the equations for separation denial rate, employer appeal rate, or employer success rate.

24. Between 1978 and 1994, 9 states imposed durational disqualifications for voluntary leaving, 12 states imposed durational disqualifications for misconduct discharges, and 15 states imposed durational disqualifications for refusing suitable work. ACUC (1995, 111).

25. For example, a state which is not adept at identifying nonmonetary eligibility violations would be paying benefits to recipients who are actually "ineligible"; this would result in low determination rates and consequently low denial rates. By contrast, a state which is very good at detecting eligibility violations would conduct a large number of determinations which would result in a large number of denials.

26. There are some drawbacks with the use of these two particular measures. For example, ACUC (1995) noted that the wage replacement rate (i.e., average weekly UI benefit divided by average weekly wage) is an inaccurate measure because the denominator is not available for UI recipients. See, for example, ACUC (1995, 126). Similarly, variations in the actual duration of benefits are more dependent upon the characteristics of the unemployed and the labor market in a given state and year than with the potential duration for which a claimant is eligible for receive benefits.

27. Tabulations from the Survey of Income and Program Participation (SIPP) indicate that while 61 percent of unemployed union members receive UI benefits, only 29 percent of unemployed non-union workers receive benefits.

28. Due to problems of data availability for a number of variables, only these 13 years were used.

29. Unlike ordinary least squares regression (OLS), the GLS model does not assume that the observations are independent of one another. Consequently, it is the preferred estimation technique for panel data, resulting in more reliable estimates of regression coefficients, standard errors, and the model's explanatory power.

30. This is presumably because more individuals are being denied benefits at an early stage in the application process.

31. According to these results, a state's denial rate for separation issues would decrease by a 0.28 percentage points (e.g., from 9.28 percent to 9.0 percent) when its tax rate increased by 0.1 percentage points (e.g., from 2.5 percent to 2.6 percent). Similarly, a state would experience a .07 percentage point decline in its denial rate for separation issues when its reserve ratio increased by 0.1.

Somewhat unexpectedly, the results also indicate that an increase in the state taxable wage base is associated with an increase in denials. This result is, however, consistent with results which indicate that an increase in states' taxable wage base increases the IU/TU much more than the associated increase in actual recipiency; the difference between the two is largely attributable to denials.

32. This last result is not expected.

33. In addition to using GLS to estimate the denial rate equations, OLS results were produced using state variables to determine the additional explanatory power of the individual state identifiers. This model specification resulted in a significant reduction in the explanatory power of many of the key independent variables, with a correspondingly large explanatory power assigned to the individual state variables. This suggests that the variables that were available for this analysis were not able to capture adequately the reasons for different denial rates across states. (Examples of variables that we were unable to quantify for the regression analysis include: actual definitions of nonmonetary eligibility conditions across states and over time, as well as changes in state administration of the program.) However, the ranked values of the state variable coefficients in the OLS model predicting denial rates was quite similar to the ranked values of the actual level of denial rates. Because of this similarity and the poor explanatory

power of the independent variables when state indicators were included, the actual denial rates were used in the examination of geographic patterns.

34. The inclusion of year variables (or year "dummies") allows the regression to estimate a slightly different equation for each year included in the data. This provides regression coefficients which will indicate a time trend in the data.

35. Available data from the National Center for State Courts indicates that civil court filings increased over 5 percent per year between 1978 and 1990.

36. Employees may also be required to pay payroll taxes in four states. See Advisory Council on Unemployment Compensation (1995, 51) for more information.

37. The tax schedule in effect in a given state often varies based on state trust fund solvency and economic conditions.

38. See Chapter 6 of the Advisory Council on Unemployment Compensation (1995) for additional background information on experience rating, as well as a detailed discussion of the types of experience rating.

39. For example, some or all of the ultimate burden of UI taxes could be shifted from employers to workers in the form of lower wages or benefits, or to consumers in the form of higher prices.

40. Such involvement could include the following: scrutinizing former employees' UI claims, reviewing charges to their account, and participating in the appeals process.

41. As noted in technical comments to Office of the Inspector General (1985, 131), these employers may have failed to participate in the appeals process, which led to higher benefit charges and higher tax rates than other firms.

42. We are grateful to Bill Grossenbacher and Carol Skornicka for providing these data.

43. Much of the information provided in this section was taken mainly from a draft paper by Herbert Kritzer entitled *"The First Thing We Do, Let's Kill All the Lawyers" (or at Least Replace Them?): Lawyers and Nonlawyers as Advocates.*

44. The Texas data were not used because the state's appeals are vary different from the national average; employers are a very large proportion of all appellants and claimants win a larger percentage of all appeals. In addition, information on representation was not available.

45. A variable measuring whether the firm was paying the maximum tax rate was also considered. Because it was not statistically significant in either the employer or the claimant regression equations, it was dropped from the analysis.

46. A variable measuring whether both the claimant and the employer had representation in the hearing was also considered. Because it was not statistically significant in either the

employer or claimant regression equations, it was dropped from the analysis.

47. The model was also run in OLS and probit; however, in all cases, the models did not correctly account for the error distribution of the data.

48. The model was significantly better at predicting when an employer would lose an appeal than when an employer would win an appeal. It correctly predicted when an employer would lose an appeal in 99 percent of the cases, but it correctly predicted when an employer would win an appeal in only 4 percent of the cases.

49. Like the employer model, this model was significantly better at predicting when a claimant would lose an appeal than when a claimant would win an appeal. It correctly predicted when a claimant would lose an appeal in 94 percent of the cases, but it correctly predicted when a claimant would win an appeal in only 17 percent of the cases.

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Advisory Council on
Unemployment Compensation

A History of the Unified Budget and Its Unified Budget and its Implications for Unemployment Insurance

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KRA Corporation
Robert F. Cook
Lisa Creatura
Alexandra Tan

Unified Budget Creation

Prior to fiscal year 1969. the Federal budget did not include the State's Unemployment Insurance (UI) trust fund accounts in the totals for Federal spending and receipts. Designed as a Federal-State partnership, the original legislation for UI required special handling of the employer taxes in each State's UI program. Since these tax contributions were to be the sole financing source for benefits and could not be used for any other purpose, it was important that they be separated from other State revenues and carefully administered. To accomplish this objective, the legislation required that each State deposit receipts from employer taxes into an individual State trust fund account to be maintained and administered by the U.S Treasury. The U.S. Treasury was to hold these funds "in trust" for each State, with fund transfers on demand to the States for the purpose of paying UI benefits.

The Federal budget included only receipts and expenditures moving into and out of the general fund of the Treasury that were subject through the appropriations process. The financial transactions of, as well as other Federal programs that were accounted for through trust funds, were kept separate from the administrative budget, except for purposes of economic analysis. However, a brief discussion of various accounts and trust funds, titled *Federal Receipts From and Payments to the Public*, was included with each annual budget and represented a consolidation of the administrative budget and trust fund receipts and expenditures. This addition to the administrative budget provided the financial dimensions of the Government's overall macroeconomic stance, as well as the best measure for analyzing the cash needs and borrowing requirements of the Federal Government. Subsequently, this section of the administrative budget became known as the "consolidated cash budget."[1]

During the 1950s and 1960s, the number and size of the trust funds expanded. For the fiscal year 1967 budget, trust fund receipts were estimated to be 30 percent of receipts in the consolidated cash budget, and trust fund expenditures were estimated to be 25 percent. Consequently, the administrative budget no longer adequately portrayed the impact of the Federal Government's activities.[2]

In October 1967, President Johnson's Commission on Budget Concepts recommended that the Federal budget be unified and that the financial operations of the various Federal trust funds be shown together with those of other Government programs in a single budget. It regarded a unified budget as essential for two major reasons (1) determining economic stabilization policy and (2) allocating funds to competing programs. The comprehensiveness of the unified budget would allow for a more complete assessment of the economic impact of the budget, as well as allow for a broader assessment of spending priorities.[3]

President Johnson accepted the Commission's recommendation and presented his fiscal year 1969 budget on a unified basis. This unified budget incorporated those Federal trust funds that had previously been outside the administrative budget. These trust funds included Old Age and, Survivors Insurance, Unemployment Insurance, federally aided highway construction, Medicare, and Civil Service Retirement. The budget includes both the Federal Unemployment Trust Fund accounts (for administrative expenses, extended benefits, and the loan fund account), as well as the State benefit reserve accounts.[4] Little or no objection was raised at this time inclusion of the UI trust funds in the unified budget nor were any proposals for special treatment of the UI trust

funds introduced. The trust funds were then generating surpluses, which had the effect of offsetting military expenditures on the Vietnam war and, thus, were politically welcome.[5] The impact of the unified budget on total Government expenditures became apparent years later when deficits grew large, despite trust fund surpluses.

Increases in the unified budget deficits during the early 1970s resulted in more intense efforts by both the Executive and Legislative branches to reduce Federal spending. Subsequently, the Congressional Budget Reform Act of 1974 was enacted to force Congress to agree on the totals for budget receipts and expenditures, including those of the trust funds. The Act also created the House and Senate budget committees, as well as the Congressional Budget Office. The purpose was to provide stronger institutional support and closer scrutiny of the unified budget.[6]

Currently, separate data regarding the trust funds and a discussion of developments during the current year and those projected for the budget year are provided in the Special Analysis of the Budget. Other major trust funds in the Special Analysis include the various Social Security trust funds, Railroad Retirement funds, the Highway Trust Fund, the Airport and Airway Trust Fund, and the foreign military sales trust fund.[7]

Unified Budget and UI

The unified budget accounts for all Federal-State UI receipts and expenditures in the Unemployment Trust Fund. This trust fund has 59 accounts: 53 State UI program accounts, the Railroad Unemployment Insurance Account, the Railroad Administration Account, and four Federal accounts. The four Federal accounts in the trust fund are (1) the Employment Security Administration Account (ESAA), which funds administration; (2) the Extended Unemployment Compensation Account (EUCA), which funds the Federal half of the Federal-State Extended Benefits (EB) program; (3) the Federal Unemployment Account (FUA), which funds loans to insolvent State UI programs; and (4) the Federal Employee Compensation Account (FECA), which funds benefits for authorized Federal civilian and military personnel. Federal unemployment taxes finance the ESAA, EUCA, and the FUA, but general revenues finance the FECA. Present law authorizes interest-bearing loans to ESAA, EUCA, and FUA from the general fund. The three accounts may also receive noninterest-bearing advances from one another to avoid insufficiencies.[8]

The rationale for the current placement of the UI program in the unified budget includes the following:

- Underlying the State program is the original Federal payroll tax on employers.
- The 53 State accounts are maintained in the U.S. Treasury. Tax receipts to each of these State accounts and benefit payments from each of these accounts flow through the U.S. Treasury.
- The Federal Government is committed to support the State accounts, particularly during recessions when State funds may become insufficient to meet benefit payments commitments.

- The unified budget provides the only opportunity for a legislative body to review the UI program's budget receipts and expenditures.[9]

Several arguments have been presented to rebut this rationale. They include the following:

- State law affects the benefit levels, duration, tax rate and tax base (above the federally set minimum), methods for distributing the tax among the classes of employers, eligibility and disqualification requirements, and the administrative mechanism for payment of benefits.

- The operations of the U.S. Treasury to maintain the State accounts do not require that the accounts be included in the unified budget. The Treasury also holds accounts of a number of off-budget lending agencies.

- When and if Federal funds are advanced from general revenues, these would be reflected in the unified budget.

- State budgets do not examine the budget implications of the State UI programs. However, if changes were made in the unified budget, the States would provide for a complete budget review of receipts and expenditures.[10]

The UI program appears to be unique in its budget treatment in that expenditures that are basically under the jurisdiction of the States are included in the Federal budget. The unified budget reflects many different types of Federal-State cooperative programs; however, the funds recorded in the united budget include only Federal grants, not State contributions.[11] Although the policy decisions for each State UI program center within each State Government, the financial flow is centered in the U.S. Treasury. This appears to be the primary argument for its inclusion in the unified budget.

Modifications of Unified Budget

Since 1968, there have been a number of changes in the UI program. Federal responsibility, for example, has increased with the development of the EB program, jointly financed by Federal and State contributions program. An additional Federal Supplemental Benefits program is completely federally financed. During this time, States also modified their laws governing benefit formulas, eligibility, tax base, and employer tax rates. However, throughout this period, the Federal budget treatment of the UI program remained the same.[12]

Off-budget Federal entities are federally controlled, but their transactions have been excluded from the budget totals under provisions of law. The Congressional Budget Act of 1974 calls for the Committees on the Budget of the House and Senate to study on a continuing basis those provisions of law that exclude any outlays of Federal entities from the budget.[13]

The Gramm-Rudman-Hollings Act

In 1985, the Balanced Budget and Emergency Deficit Control Act of 1985, commonly referred to as the Gramm-Rudman-Hollings Act, was passed by Congress. The legislation amended the 1974 Congressional Budget and Impoundment Act by establishing limits for the Federal deficit for FY1986 through FY1991. It also authorized mandatory reduction, or sequestering, of Executive Branch spending, if deficit limits were not met.

The Gramm-Rudman-Hollings Act also modified the budgetary treatment of the Social Security trust funds. Under the provisions of the Act, both the Old Age and Survivor's Insurance and Disability Insurance (OASDI) trust funds were to be taken off-budget, although they were treated as on-budget when determining the size of the Federal deficit for the purposes of the Gramm-Rudman-Hollings Act through FY1991.[14] Finally, the OASDI trust funds were protected from sequestration if the budget deficit limits were exceeded.

The Omnibus Budget Reconciliation Act of 1990

The Omnibus Budget Reconciliation Act (OBRA) of 1990 made further changes to the unified budget. The OASDI trust funds were taken completely off-budget, removing Social Security from the calculation of the Gramm-Rudman-Hollings deficit caps, as well as protecting the program from automatic spending cuts when the deficit limits are not met. The 1990 budget bill also set limits for discretionary spending (primarily annual appropriations). It also requires that Congress fund direct spending (primarily entitlement programs) using pay-as-you go procedures. The limits on discretionary spending and pay-as-you go requirements are effective for FY1991 through FY1995. If any spending limits or pay-as-you go requirements are not met, automatic spending cuts again go into effect.[15]

Proposals To Change the Unified Budget

The recession of 1974 to 1975 caused all States to register major increases in unemployment benefit claims and, thus, forced them to borrow large sums from the U.S. Treasury to pay their committed benefits. The combination of more visible spending under the UI program, together with the knowledge that any reduction in benefits paid would improve the Federal deficit, has been linked to special efforts to limit spending for UI. The 1981 to 1982 recession also caused substantial borrowing, including borrowing from the general fund to support State benefit payments.

Although passage of the Balanced Budget and Emergency Deficit Control Act in 1985 removed the Social Security trust funds from the unified budget, proposals for removing the UI trust funds from the unified budget were not successful.[16]

Arguments for removing Social Security trust funds from the budget in the 1985 legislation included the following:

- Budget decisions should not cause changes to programs

- Removal would restore public confidence in the social welfare system
- Budgetary cutbacks would be more difficult to enact
- The programs are largely self-supporting
- Removal would give the program more autonomy
- Removal would enhance fiscal responsibility
- Removal would discourage expenditure of general revenues[17]

These issues are as relevant to the UI trust funds as to the Social Security trust funds.

Several recent proposals by Senator Moynihan focus on repealing the Gramm-Rudman-Hollings Act, except for those provisions that put the Social Security trust fund off-budget and not part of the budget cap. A few proposals have been made to remove the Unemployment Trust Fund from the unified budget. These proposals have been advanced by Congresswoman Long; however, all of these proposals died or were eliminated in Committee.[18] The most recent of her proposals, H.R. 3409, proposed to exclude the Unemployment Trust Funds unified budget for the purpose of calculating the deficit and discretionary spending limits. Three reasons were offered for removing these funds from the unified budget:

- **The Only State Revenues Included in the Unified Budget.** The UI program is unique because it is the only Federal-State program where State revenues are included in the unified budget.[19] As mentioned, currently the 53 State trust funds are included in the Unemployment Trust Fund and in the unified budget. These funds contain the State portion of the unemployment tax and are determined largely by State policy.

- **The Fund Is Self-Financed with Dedicated Revenue.** Long and Barca advocate removing the funds from the unified budget because UI is largely self-financed with dedicated revenue. Although this claim is true for revenues in the State UI trust funds, it does not hold true for the Federal UI trust funds. The claim also does not distinguish why UI should be treated differently from other self-financed programs.

- **Removal Will Protect UI from Funding Shortfalls.** Long and Barca believe that removing the Unemployment trust funds from the unified budget will remove incentives to underfund State administrative costs.

No recent cost estimates have been done on the effects such an exclusion would have on the overall budget according to an analyst at the Congressional Budget Office.[20] However, the General Accounting Office estimates that, had previous eligibility and benefit levels existed in the 1990 to 1991 recession, the UI expenditure nationally would have been $20 billion higher.

Effects of Including UI in the Unified Budget

Effect of Budget Caps on the Unemployment Insurance Program

The budget caps imposed by the Gramm-Rudman-Hollings Act and subsequent legislation have had several implications for the UI program. First, any additional increases in spending must be accompanied by increases in offsetting revenues, unless the additional spending is declared as an emergency. To raise additional revenues, the Government must employ one of three methods:

- Cutting spending for other programs
- Raising additional funds through the Federal Unemployment Tax Act (FUTA) revenues
- Borrowing from other funds

These caps have had both direct and indirect effects on the UI program. Since the Federal government funds all administrative costs associated with the UI program, as well as half of the EB Program, and all of the Emergency Unemployment Compensation Program (EUC), the budget caps have a direct impact on any attempts to change or reform these aspects of the UI program.

Proponents of increased administrative funding, for example, must also propose methods of financing this increase. Proposals to increase administrative funding have suggested that they be financed through changes in the FUTA tax. Proponents of providing additional UI benefits to regular UI claimants who have exhausted their benefits have also had to propose methods to finance their plans. Since 1989, numerous proposals have been introduced in Congress to either modify the EB or the EUC programs.[21] Since it may be easier to declare a program as an emergency than to increase revenues or decrease spending, no recent proposals to modify EB (a Federal-State partnership) passed, while several bills related to EUC (entirely financed by the Federal Government) did pass. Recent proposals to provide EUC benefits have been declared emergency spending and, thus, not subject to budget caps.

The budget caps have an indirect impact on the UI program as well. Since States determine many of the program's aspects, any changes made at the State level that affect the balance in the State's trust fund (i.e., changes in program eligibility requirements, duration of benefits, the State taxable wage base) in turn affect the balance in the Unemployment Trust Fund and, therefore, the unified budget deficit. Therefore, along with the concerns over State trust fund solvency and the desire to reduce State UI tax rates, the Federal Government has no interest in raising benefit levels or relaxing of eligibility requirements.

Effect of Unified Budget on the Effectiveness of UI

Incorporating UI into the unified budget and making it subject to budget caps may make the program more vulnerable to changes. Because UI is a countercyclical program, the Unemployment Trust Fund is designed to build reserves during expansionary periods and draw down on these reserves during recessions. However, increases in the balance of these programs may hide increases in the Federal deficit or encourage spending in other programs unrelated to UI. In recessionary periods, decreases in reserves may need to be accompanied by reductions in program spending either in UI or in other programs.

Endnotes

1. Henle, 374
2. Henle, 375
3. Henle, 375
4. Blaustein, 216
5. Blaustein, 216
6. Henle, 377
7. Henle, 376
8. Committee on Ways and Means, 426
9. Henle, 378
10. Henle, 378
11. Henle, 379
12. Henle, 376
13. Henle, 384
14. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 subsequently extended the period that the Gramm-Rudman-Hollings deficit caps were in effect until FY 1993.
15. Committee on Ways and Means, p. 87-88.
16. Congressional Quarterly, 466
17. Congressional Research Service, 45-46
18. Bills were introduced by Rep. Long in the 101st, 102nd, and 103rd Congress to remove the Unemployment Trust Fund from the budget. No similar bills were introduced during these sessions of Congress.
19. Henle, 373, and Long and Barca, 1
20. Oltman, Cory. CBO, telephone interview, 4 January 1994.
21. Extended Benefits

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Unemployment Insurance Administration Financing: Compliance With the Secretary of Labor's Standards and Changing Allocation Levels

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KRA
Corporation

Robert F. Cook
Senior Economist

Joseph Kirchner
Senior Analyst

1010 Wayne Avenue
Suite 850
Silver Spring, Maryland 20910

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In 1990, 25 out of 54 State Unemployment Insurance programs did not meet all of the Secretary of Labor's Standards (SLS) for the timely performance of Unemployment Insurance (UI) claims or appeals processing. Between 1980 and 1990, the number of noncompliant States ranged from 15 to 39. Several possible explanations for this noncompliance include the following:

- The UI administrative funding formula does not provide incentives for adequate performance.
- States that do not meet the SLS fail to do so because of inefficiency.
- States become overwhelmed by increased workloads during recessions.
- The level of administrative funding is simply inadequate for States to meet the SLS.

This paper briefly examines the question of whether changes in administrative funding to the States are related to meeting the SLS.

The Current Funding Process

In the current allocation procedure, workload estimates are forecast annually across four benefit/appeals categories for each State. These estimated workloads are multiplied by minutes per unit (MPUs) and summed for each quarter. MPUs are derived from time-ladder studies performed until 1984. Workload minutes are converted to staff years and multiplied by average staff salaries. Allocations for maintaining wage records and auditing subject employers are made separately on an annual basis.

Several nonforecast activities are allocated on a percentage basis (e.g., Nonpersonnel Services [NPS] and Administrative Support and Training [AS&T]). Others, such as amounts for the Eligibility Review Program (ERP), are allocated on a historical-proportions basis (intrastate weeks claimed). Still others (e.g., Support) are allocated on the basis of so many positions for each State, with the remainder allocated proportionally.

Funding is divided between base and contingency amounts. The base amount is somewhat below estimated projections (about 75 percent of forecast workload), and the contingency funding is paid for actual workload above base. Base funding is calculated using salaries of full-time staff, while contingency funding is calculated using lower salaries on the assumption that lower paid part-time temporary staff are used.

Secretary of Labor's Standards

The Secretary of Labor requires that States meet the following standards to participate in the UI program:

- **Initial Claims Promptness - Intrastate 14/21 day**—A minimum of 87 percent of first payments made within 14 days (in Waiting Week States) or 21 days (in Nonwaiting Week States) of the first compensable week ending date.

- **Initial Claims Promptness - Intrastate 35 day**—A minimum of 93 percent of first payments made within 35 days of the first compensable week ending date.

- **Initial Claims Promptness - Interstate 14/21 day**—A minimum of 70 percent of first payments made within 14 days (in Waiting Week States) or 21 days (in Nonwaiting Week States) of the first compensable week ending date.

- **Initial Claims Promptness - Interstate 35 day**—A minimum of 78 percent of first payments made within 35 days of the first compensable week ending date.

- **Lower Authority Appeals Promptness - 30 days**—A minimum of 60 percent of appeal decisions made within 30 days.

- **Lower Authority Appeals Promptness - 45 days**—A minimum of 80 percent of appeal decisions made within 45 days.

In the current analysis, we will use only 14/21 day initial claims promptness and lower authority appeals promptness.

Administrative Funding and Compliance

In late 1994 and early 1995, KRA also examined this issue,[1] using regression coefficients from a production frontier cost model of States in compliance with the SLS. These coefficients were used to estimate funding levels of all States that should allow them to meet the standards. The assumption made was that if funding was adequate for the compliant group of States, equivalent funding adjusted for workload salary levels and environmental variables for the noncompliant States should be adequate to allow them to meet the standards. The standards used were 14/21 day intrastate first payment promptness and 30-day lower appeals promptness. Differences among the States in wage levels, population density, unemployment rates, size of the labor force, number of initial claims and appeals, and percent employment in services, manufacturing, mining, and construction were included in the model. The results indicated that although some noncompliant States would receive additional funding, slightly more than half would receive less funding and total funding for noncompliant States would go down slightly.

In the current analysis, we look at the relationship between UI administrative funding and whether States are in compliance with the 14/21 day intrastate initial claims payment promptness and 30-day lower level appeals timeliness standards. We do this by examining simple correlation coefficients and regression coefficients. For the last three types of coefficient, we examine the level and first differences of four pairs of measures of funding and performance. These measures include the following:

- Compliance with total funding per initial claim

- Percent of initial claims processed in 14/21 days with funding of initial claims

- Percent of lower level appeals processed in 30 days with funding of appeals

Appeals per claim (seen as a measure of poor quality) with total funding per initial claim

For regression analyses, ordinary-least-squares (OLS) regression was used. The dependent variables are as follows: Percent of initial claims paid timely, percent of lower level appeals made timely, and appeals per initial claim. The change in compliance is a categorical variable with the following three possible values: change from compliance to noncompliance (-1), no change (0), and change from noncompliance to compliance (1). For this analysis, we use a cross-tabulation of the number of each outcome and the direction of the change in allocation. The change in funding is either -1 for a decrease in funding or 1 for an increase in funding. No States had exactly the same funding from year to year.

Data

Data for this analysis are annual data for the years 1989 to 1991. Exhibit 1 describes the variables used in the simple correlations and regression analyses. The dependent, funding, and workload variables and the wage were all taken from the DOL-ETA UIS database. Allocation data use the UI3 form, and performance measure data are from the UI Quality Appraisal program.

Results

Exhibit 2(a) shows the simple correlation coefficients and the levels of significance between timely initial claims, timely appeals, and appeals per claim with funding of initial claims, funding of appeals, and funding per claim, respectively. Exhibit 2(b) shows the simple correlation coefficients between the first differences of these series.

Exhibit 2(a) indicates that the correlation between the percent of initial claims completed in 14/21 days and funding of initial claims activities is negative and significant. The correlation between lower level 30-day appeals timeliness and appeals funding is also negative and significant. The correlation between appeals per claim and total funding per claim is positive and significant.

Exhibit 2(b) indicates that the correlations between the first differences of these same variables are similar with regard to sign and level of significance. The correlations for the two changes in timeliness measures are still negative, but not significant. The correlation between the change in appeals per claim and change in funding per claim is still positive and significant.

The tentative conclusion from these observations is that we should not be looking for strong associations between the level or change in funding and meeting the first payment and lower appeals timeliness standards. In other words, there is no evidence that an increase in funding will increase compliance.

Exhibit 1

Correlations and Regression Analyses Variables

Dependent Variables

1.	**INITIAL CLAIMS 14=**	Percent of intrastate initial claims processed within 14/21 days.
2.	**APPEALS 30=**	Percent of lower level appeals processed within 30 days.
3.	**APPEALS/IC=**	Lower level appeals divided by initial claims.

Funding Variables

4.	**FUND/IC =**	Total funding (the sum of staff and nonpersonnel services obligations from the DOL-ETA UI3 form) divided by intrastate initial claims.
5.	**INIT CLAIMS FUND =**	Funding dedicated to initial claims activities.
6.	**APPEALS FUND=**	Funding dedicated to appeals activities.

Workload Variables

7.	**INITIAL CLAIMS =**	Number of intrastate initial claims.
8.	**APPEALS =**	Number of lower and higher level appeals.

Cost Variables

9.	**WAGE =**	The price of labor calculated as total staff payments (UI3 obligations)^2 divided by total staff years paid (UI3 Part A).
10.	**RENT=**	Proxy variable for the price of capital calculated as residential rent in each State's capital inflated by the U.S. Consumer Price Index.

Labor Market and Geographic Variables

11.	**LABORFORCE % US =**	State labor force as a percent of the total U.S. labor force.
12.	**DENSITY =**	State population divided by the size of the State in square miles.
13.	**SERVICE % =**	State employment in service industries as a percent of total State employment.
14.	**MFG CONS MIN % =**	State manufacturing, construction, and mining employment as a percent of total employment.

Exhibit 2 A&B

Correlation Coefficients

	INITIAL CLAIMS 14	APPEALS 30	APPEALS/IC
INIT CLAIMS FUND	-0.2447 ***		
APPEALS FUND		-0.2606 ***	
FUND/IC			0.4206 ***

	THE CHANGE IN INITIAL CLAIMS 14	THE CHANGE IN APPEALS 30	THE CHANGE IN APPEALS/IC
THE CHANGE IN INIT CLAIMS FUND	-0.0186		
THE CHANGE IN APPEALS FUND		-0.1191	
THE CHANGE IN FUND/IC			0.5100 ***

* Significant at the 10 percent level
** Significant at the 5 percent level
*** Significant at the 1 percent level

Regression Analysis

Exhibit 3 presents the results of the regressions. Six equations are presented. The regression coefficient for initial claims funding relative to the percent of initial claims paid timely (equation 1) is negative and significant at the 5 percent level. The coefficient for appeals funding relative to the proportion of lower appeals completed timely (equation 2) is positive, but not significant. When the first differences of funding are used (equations 3 and 4), the signs are reversed, but neither are significant at the 10 percent level.

Equations 3 and 4 were also estimated without including the change in the number of initial claims and the change in the number of lower level appeals, which are not shown here. The initial claims funding coefficient was positive, and the appeals funding coefficient was negative. Neither was significant.

The regression coefficient for funding per claim in the appeals per claim (equation 5) is positive and significant at the 1 percent level. This implies that high levels of funding per claim, controlling for environmental factors, are associated with higher numbers of appeals per claim. This is due to endogenous changes in funding. The regression coefficient for the change in funding per claim relative to the change in appeals per claim (equation 6) is also positive and significant.

Each of these six equations was estimated with the addition of another variable—the State rate of unemployment. In no case did the inclusion of this variable make a difference in the sign or the level of significance of the funding coefficients.

Change in Funding and Change in Compliance

Finally, we looked at whether the change in total funding from year to year over the 3-year period was positive or negative and whether the States remained the same in terms of compliance for first payments of initial claims and lower level appeals relative to whether the State's total funding for administration of the program increased or decreased. This analysis produced the results presented in Exhibit 4.

The columns in the table indicate whether the State's administrative funding increased or decreased for the year. The total column indicates the row total for those States that moved from noncompliance to compliance standards although they had not in the previous year (1), remained the same (0), or moved from compliance to noncompliance over the previous year (-1).

A total of 76 States did not change their compliance over the previous year. Of these States, 71 had their administrative funding increased and 5 had their administrative funding decreased. Of the eight States that shifted from noncompliance to compliance with the intrastate first payment promptness and lower appeals promptness, six experienced an increase in funding and two experienced a decrease in funding. Finally, of the 18 States that went from compliance to noncompliance, 14 experienced an increase in administrative funding and 4 experienced a decrease. The Spearman rank correlation for these results is 0.069, and the level of significance is 50 percent (not significant).

Exhibit 3
Regression Equations

DEPENDANT VARIABLE	(1) INITIAL CLAIMS PERCENT TIMELY	(2) APPEALS PERCENT TIMELY	(3) CHANGE IN INITIAL CLAIMS PERCENT TIMELY	(4) CHANGE IN APPEALS PERCENT TIMELY	(5) APPEALS PER INITIAL CLAIM	(6) CHANGE IN APPEALS PER INITIAL CLAIM
MULTIPLE R	0.4297	0.6070	0.3395	0.3350	0.4954	0.6332
R SQUARE	0.1846	0.3684	0.1153	0.1122	0.2454	0.4009
ADJUSTED R SQUARE	0.1393	0.3333	0.0391	0.0359	0.2090	0.3563
STANDARD ERROR	3.4946	18.9831	2.4619	14.9838	0.0213	0.0064
F	4.0761	10.5002	1.5143	1.4695	6.7373	8.9857
% CORRECT						
VARIABLES						
CONSTANT	95.1556 ***	176.4555 ***	-0.4107	21.9464	0.0508 **	-0.0004
FUND/IC §					0.0003 ***	0.0003 ***
INITIAL CLAIMS FUND §	-1.8E-07 **		2.4E-07			
APPEALS FUND §		8.6E-07		-2.0E-07		
LABORFORCE % US	37.5040	-90.0644	10.1921	-55.2175	0.1076	-0.0757 **
DENSITY	0.0012 **	0.0092 ***	0.0001	0.0068	-1.7E-06	-1.5E-06
SERVICE %	-0.2020 **	-0.1968 ***	-0.0667	-1.2009 **	0.0007	-0.0001
MFG CONS MIN %	0.0751	-0.9792 ***	0.0277	-0.2437 **	-0.0005	0.0001
INITIAL CLAIMS §	2.2E-06		-0.7527 **			
APPEALS §		-1.8E-04		-1.7E-04		
RENT	-0.0018	-0.0298	0.0053	0.0262	-4.7E-06 **	1.1854E-05
WAGE	3.6E-05	-0.0046 ***	-0.0001	-0.0010	-1.3E-06	-2.4E-07
NUMBER OF CASES	153	153	102	102	153	102

* Significant at the 10 percent level
** Significant at the 5 percent level
*** Significant at the 1 percent level
§ The first difference of these variables are used in equations 5,6, and 8

Exhibit 4
Change in Compliance Versus Change in Funding

Change in Compliance Versus Change in Funding

	Increase in Total Funding	Decrease in Total Funding	Row Total
Noncompliance to Compliance	6 6.6%	2 18.2%	8 7.8%
No Change	71 78.0%	5 45.5%	76 74.5%
Compliance to Noncompliance	14 15.4%	4 36.4%	18 17.6%
Column Total	91 89.2%	11 10.8%	102 100.0%

Conclusion

These results lead us to believe that, as in our earlier research and that of others, it is not possible to relate the level or change in administrative funding to performance. We believe that there are several reasons for this. First, as noted above in the Current Funding Process section, the nature of the allocation process is that administrative funding is related to workload so that looking at increases in workload or funding relative to performance is fraught with intercorrelations. Another is that, as the workload goes up, the funding per unit of workload goes down, leading to spurious relationships with the change in funding. Although we can identify long-run efficiencies of scale, it is not possible to identify short-run efficiencies relative to capacity.

Cyclical Relationships

There is evidence that compliance is procyclical. Exhibit 5 shows that the number of noncompliant States was high following the 1982 recession and the 1991 to 1992 recession. The correlation between the State unemployment rate and noncompliance for the 1989 to 1991 period is 0.13 and is significant at the 1 percent level.

Incentives

Since 1986, the Department of Labor has requested comments on the incorporation of performance or productivity-based incentives into administrative funding for the Federal-State UI program.[3] However, performance measures to date have not been incorporated. Incentive-based funding criteria could help. If, for example, States that met the standards received a 5 percent increase in their allocation for the subsequent year, they might show an improvement in compliance with the SLS.

Exhibit 5

Compliance With the Secretary of Labor's Standards

Year	Compliance	Noncompliance	Total
1982	25	29	54
1983	17	37	54
1984	28	26	54
1985	29	25	54
1986	23	31	54
1987	29	25	54
1988	39	15	54
1989	36	18	54
1990	29	25	54
1991	27	27	54
1992	15	39	54
1993	23	31	54

Endnotes

1. Joseph Kirchner and Robert F. Cook (February 1, 1995). "Unemployment Insurance Administration Financing: Relative Efficiency and Adequate Funding," *Advisory Council on Unemployment Compensation.*

2. Staff years paid divided by staff obligations is a better measure than the PS/PB rate, which only reflects the contingency average pay rate. Contingency pay is less than base pay because, presumably, less expensive part-time workers are used.

3. See *Federal Register*, Volume 52, No. 15, Friday, January 23, 1987, pp. 2627-2628; *Federal Register*, Volume 51, No. 146, Wednesday, July 30, 1986, pp. 27270-27276.

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UNEMPLOYMENT INSURANCE ADMINISTRATIVE FUNDING
AND
UNEMPLOYMENT INSURANCE PROGRAM OUTCOMES

October 21, 1994

LITERATURE REVIEW

Prepared for

The Advisory Council on Unemployment Compensation

by

Bennett E. Cross
Dr. William W. Ross

Fu Associates, Ltd.
2300 Clarendon Boulevard
Arlington, VA 22201

PERFORMANCE-BASED FUNDING
OF
ADMINISTRATIVE ACTIVITIES
IN
STATE UNEMPLOYMENT INSURANCE PROGRAMS

I. Introduction

The purpose of this paper is to review information on public programs and industries that may be relevant to the goal of establishing a nexus between performance and appropriate funding levels for the administration of State Unemployment Insurance (UI) operations. The paper is based on a review of research and discussions with subject matter experts (SMEs) relevant to determining how the efficiency of operation and the quality of administration provided to UI claimants, employers, and taxpayers could be used as key inputs to determining appropriate levels of State funding. Given the complexity of the subject, the paper is not intended to be exhaustive or to propose an alternative methodology for UI administrative funding. Its goal is to provide a discussion of several concepts that may prove useful in contemplating an "ideal" funding approach.

The organization of the remainder of this paper is as follows. Section II reviews the extent to which the current funding system for UI administrative activities and the proposed AFI system incorporate performance measures in their respective methodologies. Section III summarizes the major Federal and State programs in place for measuring and evaluating quality in the UI system and some of the potential challenges involved with using such programs for improving administrative operations and determining funding allocations. Section IV reviews studies that have systematically attempted to examine relationships between administrative costs and quality of administrative activities. Section V reviews other relevant research that has been carried out in either other Federally-funded programs or service industries that may have examined or incorporated the relationship between cost and quality. Section VI examines regulated industries for possible guidance on linking quality measures to funding formulae. Section VII has the same purpose but pertaining to the claims processing activities of the private insurance industry. Section VIII concludes the paper with some suggestions for thinking about a funding system that takes into account performance.

II. UI Administrative Funding Systems

Funding methodologies for the Federal-State UI system have evolved significantly since the inception of the program. In earlier years, Federal grants for administrative activities were based on detailed, line-item budgets submitted by the States, or subsequently on workload-based estimates of the costs of performing each administrative activity. The cost estimates were based on time-and-motion studies or by States' past experiences. In 1963, the Department of Labor (DOL) simplified the system by reducing the number of budget functions.

The Current Funding System

The current funding approach operates according to the Cost Model Management System.[1] The Cost Model system was developed during the 1970's as a result of an effort to begin funding States according to the specific level of effort required in each State to perform detailed administrative activities. The Cost Model is based on Minutes Per Unit (MPU) values unique to each State for each component of UI workload activity. These MPUs were based on time-and-motion studies conducted in each State. Using a computer model, DOL combines MPU and workload figures to produce State staff year allocations. Under the Cost Model, States receive UI administrative funds in the following three broad categories: regular UI operations; administrative staff and technical services (AS&T); and nonpersonal services (NPS).

Since 1985, DOL has discontinued updating estimates of Cost Model MPUs due to budgetary considerations stemming from the labor-intensive requirements of the time-and-motion studies. In 1985, Congress and DOL initiated new attempts to reform the UI administrative funding system. Federal and State administrators of the UI program have become increasingly aware of problems with the current funding system. Perceived problems include: work measurement (i.e., MPU) factors outdated by changing technology and management organizations, disincentives to productivity and efficiency, overly complex funding methodologies, the perception that funding is insufficient for supporting basic UI infrastructure operations, and a lack of funding stability and predictability for States.

The Administrative Financing Initiative System

The Administrative Financing Initiative (AFI) system was launched by DOL in response to a mandate from Congress to reform the UI administrative funding system.[2] The basic methodology proposed under AFI has been designed to assist in the amelioration of many of the problems noted above with respect to the current system. The proposal is currently being reviewed by interested parties.[3]

The AFI methodology would modify the funding methodology by basing State grants on a combination of national averages and State-specific measures of the resources required to carry out claims processing and employer-related activities. The key concepts used for applying dollar values to State funding are Benefit and Tax National Unit Costs (NUCs), which are, respectively,

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[1] The current funding system is also described in Briefing Papers of the Advisory Council on Unemployment Compensation, ACUC, Portland, ME, June 16-17, 1994.

[2] The Emergency Unemployment Compensation Act of 1991 (P.L. 102-168) mandated the Secretary of Labor to report to Congress on revisions to the UI administrative funding system.

[3] See UIS Information Bulletin No. 13-94, Unemployment Insurance Service, U.S. Department of Labor, June 7, 1994 and AFI Reference Report, Unemployment Insurance Service, U.S. Department of Labor, June 24, 1994.

representative measures of the observed costs of processing claims (the Benefit NUC) or employer-related functions (the Tax NUC).

The AFI simplifies the measure of each State's administrative workload relative to the current system (Cost Model) by using a smaller number of activities in the calculations. State workload mix is measured using individual State workloads for the smaller core of activities and national average measures of the staff year resources required to carry out those activities. Interstate cost differences are also taken into account through the use of State salary indices and an adjustment for cost disadvantages experienced by low population States.

Although the AFI methodology is radically different from the current funding system, it is similar in that it utilizes workloads and workload projections to determine allocations. Also, the NUCs are determined using measured costs (obligations) whose levels are affected by the current funding system methodology.[4]

The Current and AFI Funding Systems and Performance

Both systems described above determine State funding allocations based on projected measures of workload and the resources required to process that workload. Neither system explicitly evaluates individual State performance with respect to efficiency or quality of service in determining the levels of funding each State is to receive.

The Current System

Under the current system, States are funded according to efficiency (productivity) measures established several years ago. Thus, State funding allocations are significantly affected by the productivity levels that organizational structures, State laws, and work practices determined historically. With respect to quality of service to claimant clients or administrative quality, States are not funded according to their performance. As reviewed in Section III below, DOL operates and funds the States for various efforts to measure, monitor, and improve the quality of benefit payment and tax collection operations. However, with the exception of a "death penalty" provision (i.e., a complete cessation of funding), which has never been invoked, these programs themselves have no direct effect on State funding levels.

[4] Certain other features of the current funding system are retained in the AFI methodology, including the division of a State's allocations between a base funding and above base or contingency funding and the provision of dollars for technical assistance and innovation grants (known under the current system as Automation Grants).

The AFI System

Similar to the current funding system, the proposed AFI system does not incorporate measures of the quality of administrative activities into the AFI methodology. However, the AFI does incorporate national standards of efficiency in two key components of its methodology. First, the NUC, is a national average measure of the cost of carrying out administrative activities. Because the NUC is applied uniformly (before State-specific adjustments) to all States, its use will require that each State operate its programs according to the national average level of resources (costs) of processing a unit of benefit and tax related workload.[5] Second, AFI accounts for each State's workload mix in determining allocations by using national average measures of productivity in carrying out key administrative activities. These "Workload per Staff Years" (WL/SYs) are used to project total benefit and tax workloads level for each State.[6] State funding is thus determined, in part, by a national standard or measure of productivity or efficiency.

In terms of quality standards, the AFI follows the precedent of the current funding system in making no attempt to incorporate standards of quality or quality incentives into determination of the levels of funding that each State receives. Consideration was given early on in the AFI process to incorporating explicitly quality of service as possibly reflected by State law differences and other measures of performance. However, after examining various options for the AFI, DOL analysts concluded that the incorporation of quality, "best practices," or State law differences in determining funding levels would be very difficult to carry out and inconsistent with AFI goals of operational simplicity and the use of nationally objective data. Also, DOL stated that it would prefer to remain neutral on the issue of quality for the purposes of a funding allocation methodology.[7]

III. Defining and Evaluating Quality of Performance in UI Administration

The process of measuring administrative performance for a public program can take on several dimensions. The following presentation of definitions of performance is intended to facilitate subsequent discussions in the paper. Given the considerable amount of analysis that has been conducted by others on the definition and measurement of quality in the UI program, the

[5] As stated above, this average cost is adjusted for legitimate State differences.

[6] WL/SYs have can be understood as measures of productivity, but also as inverse measures of the level of resources that States require to perform a given level of administrative activity. Under AFI six workload measures involving claims processing activities and two measures involving tax activities are used.

[7] See the AFI Options II Paper, pp. 54-56 and the AFI Reference Report, pg. 53. The AFI analysis reviewed in Section IV was used in the AFI process to guide deliberations on the issue of incorporating measures of quality in determining funding allocations.

definitions are not intended to be complete or definitive, but rather to present key concepts of performance that can be linked to administrative costs or funding levels.

The Distinction between Quality and Efficiency

Quality

Quality of administrative performance can be examined from at least two interrelated perspectives that reflect basic goals of the Federal-State UI system. The first perspective involves the quality of customer service. This concept involves the timely, equitable, and accurate treatment of UI claimants and employers subject to the program. A fundamental UI program objective states that qualified unemployed workers should receive timely claims processing, accurate payment of benefits, and fair and timely treatment when disputes over eligibility or payment arise. The second perspective involves the ability of State UI operations to protect and manage public funds through proper and accurate payment of benefits and collection of revenues from subject employers. Obviously, these two perspectives on quality overlap. Accurate payouts and revenue collections can support the objectives of fair and timely treatment to program participants and accounting of public funds.

Efficiency

Another measure of administrative performance involves efficiency. Efficiency refers to the resources (costs) required to perform a specified level of administrative activity at a given level or range of quality. Efficiency is closely related to the concept of productivity, which, in the case of the UI program, is usually measured by the staff resources required to process a unit of administrative activity. As noted above, the current funding system takes States' levels of efficiency as given and pays them according to their historical levels of productivity. As also noted, the AFI system does impose a standard of efficiency, notably through the NUC, since it represents the average level of productivity and rewards higher-than-average levels.

The Connection between Efficiency and Quality

In discussions of ways to improve both quality and efficiency in UI program operation, a common view has been that there is a relationship between the two that should be accounted for. For example, it is believed by some that higher quality operations may require more funds because increasing accuracy, promptness, or other improvements may require a larger, better-trained staff or the application of more automated, expensive procedures. The logical implication then is that any well-founded funding formula should take into account such a relationship. Evidence on the relationship between cost and quality and the implications for administrative funding is discussed below.

Current Programs for Measuring and Improving Performance in UI Administration

The Federal government and the States have several programs in place for monitoring UI operations in the States and encouraging the enhancement of program performance. Numerous studies and analyses have been carried out that evaluate various aspects of these programs.[8] The Federal programs briefly outlined below are those that would be most relevant to any considerations of a performance-based administrative funding mechanism.

Monitoring and Encouraging Efficiency

The UI system has undergone extensive scrutiny over the years--at the Federal DOL level, within the States, and by outside evaluators--with respect to ways to improve productivity and efficiency in claims processing and tax activities.[9] The Federal government has until recently monitored efficiency through the Cost Model Management System, which determined the number of MPUs

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[8] See for example:

Bright, Jack (Ed.); *Leadership in Appellate Administration: Successful State Unemployment Insurance Appellate Operations*; UI Occasional Paper 89-7; Washington: Division of Program Development and Implementation, Office of Program Management, U.S. DOL/ETA/UIS; 1989.

Burgess, Paul L. and Kingston, Jerry L.; *An Incentives Approach to Improving the Unemployment Compensation System*; A National Chamber Foundation Report; Kalamazoo, MI: W.E. Upjohn Institute for Employment Research; 1987.

Corson, Walter; *Nonmonetary Eligibility in State Unemployment Insurance Programs*; Kalamazoo, MI: W.E. Upjohn Institute for Employment Research; 1986.

Hanson, W. Lee and Byers, James F. (Ed.); *Unemployment Insurance, the Second Half-Century*; Madison, WI: University of Wisconsin Press; 1990.

U.S. GAO; *An Assessment of Random Audit--A New Department of Labor Program to Improve the Accuracy of Unemployment Insurance Benefit Payments*; Report to the Secretary of Labor; GAO/HRD-84-26; Washington, March 30, 1984.

[9] Examples of such examination include various Government Accounting Office studies. See *Millions Can Be Saved by Improving the Productivity of State and Local Governments Administering Federal Income Maintenance Assistance Programs*, Report to the Congress by the Comptroller General, June, 1981; and *A Comprehensive Approach Needed for Further Productivity Improvements in the Unemployment Insurance Program*, Report to the Secretary of Labor by the U.S. GAO, October 25, 1984.

each State required for each type of administrative output. These data have been used by the Unemployment Insurance Service (UIS) Budget Office in allocating the budgeted funding among States.

Many observers believe that the current funding system discourages efficiency, since States requiring more MPUs per unit of workload are funded at a higher rate than other States. In other words, States that are less efficient (spend more time processing each claim) receive more money per claim. The major gains in efficiency in the program have probably resulted from individual State initiatives to automate, reorganize operations, adopt new techniques, and other improvements. Federal training, automation grants, and interstate information sharing have probably also played a role in assisting States to improve productivity.

Quality Control

The Quality Control (QC) program is operated with the purpose of assisting Federal and State Employment Security Agency (SESA) staff in identifying errors in benefit payments and revenue collection and in correcting problems in these areas. The ultimate goal of the QC program is to achieve improvements in the accuracy and integrity of the UI program through error reduction, while encouraging more efficient administration. Unlike the Quality Appraisal (QA) program described below, QC incorporates neither explicit performance standards nor corrective action requirements on the States.[10] The QC program operates with a State role of drawing samples, performing investigations, identifying errors, analyzing data, and initiating corrective action. The Federal role involves the use of the sampled QC data to monitor SESA practices and the impact of Federal program requirements on UI system participants. Benefits QC is the more established of the two programs operated under QC. At this stage, the Revenue QC program is under development and is slated for nationwide implementation in January 1995.

Benefit Payment Control

Benefit Payment Control Programs (BPC) are Federally funded and assisted, State-run programs involving the specific search for, and examination of, cases of incorrect payment and fraud in the expenditure of UI benefits. States have ongoing BPC programs and, in contrast to the sampling-based approach used under Benefits QC, State BPC staff undertake specific investigations of cases suspected of involving fraud and work to recapture overpayments. National and regional Employment and Training Administration (ETA) offices have personnel allocated to assist States

[10] Under QC, the DOL national office is authorized to impose (and has imposed) financial sanctions on States not fulfilling their operational responsibilities within the QC program. However, these potential sanctions do not involve a direct linkage of benefit payment performance or revenue collection to the funding of those activities.

in controlling benefit payments and in monitoring State BPC program effectiveness. Unlike other programs described in this section, the BPC program is not considered a quality measurement or monitoring system. Varying State laws and operational characteristics render the ability of using BPC for cross-State comparisons or the establishment of Federal standards, very problematic.

Quality Appraisal

The Quality Appraisal (QA) system involves the application of several measures and standards for timeliness, completeness, and accuracy in administrative processing. Key objectives of the QA program include Federal oversight of the quality of State operations, promotion of corrective action in the States, and assistance with national program planning. The QA system measures each State's performance in 25 categories of timeliness and accuracy (see Table 1 on the following page) and compares each of these figures to the corresponding standard for that category. The core standards are the Secretary's Standards (SSs). The remaining standards are known as Desired Levels of Achievement (DLAs). The Secretary's Standards involve the promptness of 1) first payments of Initial Claims and 2) Lower Level Appeals, and are established by regulation as ultimate requirements for State receipt of administrative funds. States potentially can be denied payment if these SSs are not achieved after a remedial period. In practice, this "death penalty" regulation has never been invoked.

The remainder of the 25 DLAs are specific objective measures for performance in benefits, tax/employer, and UI fund management. When established, the DLAs were intended as "ideal" performance measures that encourage State-level improvements according to State discretion. Now, in practice, DLAs are treated virtually the same as the Secretary's Standards by Federal and State participants.

Examining the benefit benchmarks summarized in Table 1, the initial claims measures are fairly self-explanatory. The initial claims promptness standards require that, for a specified minimum percentage of claims, the first benefit payment be made to the claimant within a specified minimum time from the date the claim is filed. The performance standards shown in Table 1 for nonmonetary determinations require that a specified minimum percentage of cases have acceptable scores based on the QA system for evaluating nonmonetary determinations, which is commonly referred to as "QPI."[11] The nonmonetary determinations promptness standard requires that a specified minimum percentage of cases be disposed of in a timely fashion. The combined wage claims promptness standard requires that a specified minimum percentage of wage transfers be made in a timely fashion. The appeals performance standard requires that a specified minimum

[11] *A Performance Based Quality Control Program for Nonmonetary Adjudication*, ETA Handbook No. 301.

TABLE 1				
DESIRED LEVELS OF ACHIEVEMENT AND SECRETARY'S STANDARDS				
#	ITEM	MEASURE	MIN/<MAX>	LIMIT *
	Initial Claims			
1.	**Intrastate**	**First payments**	**87%**	**14/21 days**
2.	**Intrastate**	**First payments**	**93%**	**35 days**
3.	**Interstate**	**First payments**	**70%**	**14/21 days**
4.	**Interstate**	**First payments**	**78%**	**35 days**
5.	UCFE	First payments	70%	14/21 days
6.	UCFE	First payments	78%	35 days
7.	UCX	First payments	87%	14/21 days
8.	UCX	First payments	93%	35 days
	Nonmons (Intrastate)			
9.	Performance-sep.	Acceptable cases	75%	
10.	Performance-nonsep.	Acceptable cases	80%	
11.	Promptness	Determinations	80%	Timely
12.	Comb Wage Clms.	Wage transfers	75%	Timely
	Appeals			
13.	Performance	Cases/score	80%/80	
14.	**Lower Auth prompt**	**Decisions**	**60%**	**30 days**
15.	**Lower Auth prompt**	**Decisions**	**80%**	**45 days**
16.	Higher Auth prompt	Decisions	40%	45 days
17.	Higher Auth prompt	Decisions	80%	75 days
	Tax			
18.	Status Determination	Employer liability	80%	180 days
19.	Field Audits	Penetration-Contributory	2%	
20.	Field Audits	Penetration-Large	1%	
21.	Report Delinquency	Employer filings	95%	End of Qtr
22.	Collections	Accounts collected	75%	150 days
	Cash Management			
23.	Deposit Promptness	Collected taxes	90%	3 days
24.	Clearing Acct Timing	Funds on deposit	<2 days>	
25.	BPC Recovery	Overpayments	55%	

* Waiting Week States/Non-Waiting Week States
Secretary's Standards indicated by **boldface type**

percentage of cases score a minimum of 80 points on the QA system for evaluating appeals quality.[12] The appeals promptness standards require that a specified minimum number of decisions be made within a specified time from the date the appeal was filed.

Turning to the tax benchmarks shown in Table 1, the status determination standard requires that a specified minimum percentage of determinations of employer liability be made within a specified time of the liability date. The standards for field audits require that specified minimum percentages of contributory and large employers be audited. The percentage for large employers is one percent of the "number of audits required for [the] total audit penetration rate."[13] The report delinquency standard requires that a specified minimum percentage of employers file reports by the end of each quarter. The standard for collections requires that some monies be obtained from a specified minimum percentage of delinquent accounts within a specified time from the end of each quarter.

Finally, examining the cash management benchmarks summarized in Table 1, the deposit promptness standard requires that a specified minimum percentage of collected taxes be deposited in the Clearing Account within a specified time of receipt. The standard for clearing account timing requires that all funds on deposit in the Clearing Account be transferred to the Trust Fund within a specified time from the date of deposit. The BPC standard requires that 55 percent of both fraudulent and nonfraudulent overpayments be recovered. A more detailed description of the SSs and DLAs is given in *Unemployment Insurance: Quality Appraisal Results, FY 1994.*

Cash Management Initiative

The Cash Management Initiative (CMI) is a long-term effort to improve unemployment insurance cash management by integrating modern cash management practice with deposit and withdrawal standards required under the Social Security Act. Under the CMI, DOL is considering options for ensuring procedures consistent with requirements of legislation passed by Congress in 1990 and the Treasury Department's implementing regulations. The new procedures will not affect current measures that DOL has in place for deposit and transfer performance.

Data Validation

The Data Validation program (formerly the Workload Validation program) involves the review and audit of the workload figures reported by the States in Federally required reports. The workload figures in 11 categories are examined. These data are used for administrative financing,

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[12] ETA Handbook No. 382, *Appeals Performance Criteria for Evaluating Unemployment Insurance Hearings and Decisions.*

[13] DOL/ETA/UIS, *Unemployment Insurance Quality Appraisal Results FY 94*, Washington, 1994, p. 6.

macroeconomic analysis, and UI program analysis. Under the program, States undertake validations (internal audits) of the workload counts for the activities used to fund State operations. These validations are then audited by the National Office, usually through an independent contractor. As the result of the validations, States establish corrective action plans for improving operations and workload measurement and receive technical assistance and direction from DOL National and Regional Offices.

Problems with Measurement and Effectiveness in Quality Measurement Programs

Consistent data that measures accurately how well States are performing is a requisite for any performance-based administrative funding mechanism. The above programs have received much scrutiny and have been the object of several major studies, conducted both internally and outside the UI program. These studies have evaluated the accuracy, effectiveness, and usefulness of various quality measurement and control programs.[14] Some of these studies have led to improvements and initiatives to improve or expand quality measurement.

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[14] See, for example:

Borden, William S. and Corson, Walter S.; *Performance Measurement Review, Interim Evaluation Report*; Draft Report to Employment Security, State of New Hampshire; Princeton, N.J.: Mathematica Policy Research, Inc.; May 1993.

Burgess, Paul L. and Kingston, Jerry L.; *An Incentives Approach to Improving the Unemployment Compensation System*; (cited above).

Burgess, Paul L. and Kingston, Jerry L.; Estimating Overpayments and Improper Payments; Interim Report to DOL/ETA/UIS, April 1980; *Unemployment Compensation: Studies and Research*; p487; Washington: U.S. DOL/ETA/UIS; 1980.

Hanson, W. Lee and Byers, James F. (Ed.); *Unemployment Insurance, the Second Half-Century*; (cited above).

Owen, Robert I. and Wood, Edward A.; Timeliness in Deciding Second-Level Appeals; Report to DOL/ETA/UIS, June 1980; *Unemployment Compensation: Studies and Research*; pp643-664; Washington: U.S. DOL/ETA/UIS; 1980.

Rubin, Murray; The Appeals System; Report to DOL/ETA/UIS, April 1980; *Unemployment Compensation: Studies and Research*; pp625-641; Washington: U.S. DOL/ETA/UIS; 1980.

U.S. GAO; *An Assessment of Random Audit--A New Department of Labor Program to Improve the Accuracy of Unemployment Insurance Benefit Payments*; (cited above).

U.S. GAO; *Unemployment Insurance, Administrative Funding Is a Growing Problem for State Programs*; Briefing Report to Congressional Requestors; GAO/HRD-89-72BR; Washington, May 1989.

Much of the critical evaluation of quality programs has revolved around their ability to use measures of administrative quality to compare consistently and fairly the ability of States to carry out the various missions of the UI program. Problems in using quality measurements to establish standards for determining funding levels include consistency, accuracy, and validity. Problems with consistency arise when different State programs, having different levels of administrative complexity caused by State law and regulation, are compared. As an example, a State's lower performance score on promptness for first payments relative to another State may be attributable to the former State's higher number of required procedures. Questions of the accuracy of data arises when questions surface over the ability of the States and the Federal government to produce accurate measurements of promptness, error rates or other performance measures. An example here is the large error rates found frequently during national DOL office audits of State workload validations. The question of validity arises under circumstances when States may "game" quality measurements by ensuring that workload is processed and recorded so that DOL standards are achieved.

Performance Measurement Review

Many of these potential problems are being addressed by the activities being undertaken under the Performance Measurement Review (PMR).[15] PMR is intended to be a comprehensive program for measuring State performance in administering UI and is the vehicle for revising both the QA benefit measures and attendant DLA benchmarks. PMR has also incorporated some elements of Data Validation, but has not attempted to integrate the QC functions, which deal with the propriety of specific payments, rather than the underlying procedures. Six States conducted a field test of the revised measures from July 1993 through September 1994.

PMR is being conducted by the DOL National Office, in close cooperation with SESA staff. DOL is designing the PMR measurements to be 1) customer-oriented, i.e., defining and measuring service to claimants and employers, 2) quantitatively-based, i.e., objective and free from discretionary judgement, and 3) statistically valid.

A key to the PMR approach is to develop and maintain consistent, accurate measurement systems for UI administrative tasks. The enhancements being proposed under PMR should alleviate many of the measurement problems described above and hence provide a more solid foundation for any performance-based funding program.

The Performance Enhancement System

Another more comprehensive initiative being undertaken to improve the effectiveness of the current systems of quality oversight is the Performance Enhancement System (PES). The PES

[15] The PMR is described in Borden and Corson (1993).

is not concerned directly with the measurement of quality. Its aims are more general, involving the endorsement of broad theoretical principles that should be followed to create a constantly improving UI program. In its present stage of development, the PES consists of an outline, along with written sets of goals and principles developed by a joint Federal UI/SESA workgroup. The purpose of the workgroup, which has met seven times beginning in October 1993, is to review the UI oversight system, with emphasis on the BQC program and working relationships between the SESAs and DOL.[16]

The primary underlying principle driving PES is the application of Total Quality Management (TQM) to the UI program. TQM is built around the philosophy that improvement is best achieved through a process that encourages activities that are correct when initially carried out. TQM promotes a consumer-oriented, teamwork-based framework in the UI program. To implement this system, the workgroup has recommended that the budgeting process be modified to incorporate a State-filed Quality Service Plan, which would outline each SESA's strategy for improving quality of service. The plan would be developed by the States in consultation with DOL Regional Offices and would be based on annual quality service planning guidance from the National Office, including national high priority objectives. The Regional Offices would review and approve the plans.[17]

IV. Studies on Cost/Quality Relationships in UI Administration

Whenever discussions arise concerning changes in the UI administrative funding system, a commonly proposed consideration is that funding methodologies take into account the fact that the provision of higher quality requires more resources and, hence, more funds. It is argued, most often by State UI administrators, that States have high cost programs because they are providing the high quality services to program participants called for under the objectives of the UI program. This view can be associated with the perception that the administrative process operates according to a traditional input-output production relationship, with higher levels of quality "output" requiring higher levels staffing, computers, or other inputs. The inference is that States providing higher quality administrative determinations, as possibly reflected in more complex administrative programs or State laws, or in administrative excellence, should be compensated accordingly--or at least not penalized in their funding allocations.

The positive relationship between costs and quality is understood from a related perspective that is supported by statements from States and by several studies. The view here is that changes (in recent years decreases) in funding levels tend to force changes (decreases) in the average

[16] Internal UIS/ETA/DOL memorandum to all staff from Janet Sten regarding Performance Enhancement, dated June 10, 1994.

[17] *Unemployment Insurance Performance Enhancement System*, presentation outline, Performance Enhancement Workgroup, May 1994.

reimbursable cost of carrying out administrative activities. These funding-induced changes in costs lead to declines in the quality level of those activities. Decreases in quality can occur for several interrelated reasons. One is that decreased overall funding (per unit of workload) may force SESA staff to spend less time providing quality service and careful processing of claims and employer-related activities. A related effect is that funding constraints can affect the time and money available for training or for investment in automated systems that enhance the speed and accuracy of claims processing services. Also, it is argued, funding cutbacks, especially during high workload periods, tend to force resources to be shifted to normal processing activities and away from program oversight or quality control programs.[18]

Few studies have been carried out that have attempted to examine systematically the relationship between the quality of work carried out by SESAs and the costs required to carry out that work. This section reviews the few analyses that have studied these relationships statistically. Although the review presents critical points of each study and proposes possible improvements to the analyses, we believe that the basic conclusion holds that no strong, consistent relationship between cost and quality, exists.

The Vroman Study

Wayne Vroman's 1993 study is the only analysis we found that systematically attempted to examine the relationship between the cost of carrying out administrative activities and the quality of the work conducted.[19] Vroman's model tested the ability of cross-State variation in administrative costs to explain the variation in several measures of the level of quality in processing UI claims. The measures of quality focused on claims payment and appeals promptness and benefit payment accuracy.[20] Cost was represented by an index measuring costs per covered employee in each State adjusted for workload mix and State salaries. Dollar costs were measured by annual budgeted allocations to each State. A State's level of covered employees was intended to proxy for the potential workload faced by each State.

Vroman's model was estimated using a cross-sectional regression framework. The model incorporated State-covered employment levels to control for the possible effects of size of operation on quality. Vroman's major conclusion from comparing the results for several measures of quality was that there is no statistical support for the view that administrative costs are positively related with the quality of administrative outcomes--as measured by the above

[18] These and related arguments are emphasized in Burgess & Kingston (1990) and U.S. GAO (1984).

[19] Vroman, W., "Costs and Quality in Unemployment Insurance Administration," Prepared for UIS/DOL, August, 1993.

[20] Specifically, Vroman's analysis examined promptness on first payments for intrastate claims, first payments for interstate claims, lower authority appeals, and higher authority appeals. Payment accuracy was evaluated according to benefit quality control payment error rates.

indicators. The analysis did find some evidence that promptness of administrative determinations is better in small than in large States and that larger States perform better in benefit payment accuracy. However, Vroman's statistical model, which used costs as a key explanatory variable, could only explain very little of interstate variation in claims processing quality.

One problem with the analysis is that its cross-sectional approach compares States in their cost-quality relationships rather than examining how quality and cost may vary for individual States over time. As stated above, one argument supporting a positive relationship between cost and quality is that quality of operations has declined as State's per unit levels of funding (hence costs) have declined. By examining how quality changes from year to year within States as average costs vary, the hypothesis that lower funding leads to lower quality can be examined.

Another problem with the study is that it uses allocation data (Federally-budgeted funding levels to each State) rather than actual expenditure data. One improvement to the analysis would involve the use of cost accounting data that has since been collected and compiled as a component of the AFI project.[21] Use of such data might provide a better measure of costs than the data available to Vroman at the time of his study. Vroman's measure of individual State workload is also a proxy that could be made more precise by use of actual annual measures of major administrative activities (weeks claimed, initial claims, nonmonetary determinations, appeals).

The AFI Study

Another effort to examine the possible implications of relating average administrative costs (and hence funding) to quality performance among States was carried in conjunction with AFI.[22] In response to suggestions from several States, DOL examined the implications of using quality-adjusted National Unit Costs as the basis for determining the grant allocations for all States with regard to funding benefit and tax activities. The philosophy behind the suggestion was that a funding system based on observed average costs per unit of workload should focus on those efficiency levels revealed by the average costs of States that are carrying out key functions at higher-than-average quality levels.

The exercise consisted of calculating benefit and tax unit costs based on financial data for States considered high quality operations for tax and benefit operations during three recent years (1991-93). On the benefit side, States with available financial data that were among those in the upper distribution of States missing the fewest SSs and DLAs, and that had the lowest BPC

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[21] Under AFI, calculation of the NUC requires the development of the average costs of carrying out benefits and tax activities. Average cost is the dollar cost per unit of benefit (or tax workload). Such average data for 1989-92 has been collected and processed.

[22] See AFI Reference Report, pp. 42-43 and Fu Associates, "Using Quality NUC's to Calculate AFI Grants." Internal Memorandum to AFI Ad Hoc Working Group, March 14, 1994.

overpayment rates were chosen. On the tax side, the upper half of States missing the fewest DLAs were chosen. This methodology resulted in calculating a NUC that used data from 15 quality States for benefits and 20 quality States for tax. The resulting benefit and tax NUCs were significantly lower than would be used under the NUCs currently proposed for AFI. The net effect of using such quality-adjusted NUCs under the AFI methodology would be an annual reduction in total administrative grants of approximately 15 percent.[23]

The above exercise suggests that many States are administering high quality operations at or below the average funding level proposed under AFI. It suggests that the quality-cost relationship may even be negative for many States--just the opposite of the hypothesis outlined above. If such a relationship holds in the UI administrative system, then it supports evidence found in other organizations and industries that high quality operations are often low cost operations that result from a propitious selection of State laws and regulations, superior management practices, automation, or other factors.

One problem with this approach is that it involved nonrigorous cross-sectional comparison of average costs for two sets of States. The use of a more extensive, multivariate regression approach that examines cost and quality relationships across States and over time, would perhaps provide more robust results. This multivariate analysis would follow the suggestions offered above for enhancing the Vroman study.

The Macro Study

The only other analysis we find that even tangentially studied possible relationships between administrative costs and quality was a study by Macro International, Inc., conducted by Crosslin et al.[24] As part of a broader study that examined relationships between administrative costs (as proxied by staff years) and UI workload, the authors examined the possible effects of variations in key State laws on staff requirements. Because some State managers have argued that variations in State law complexity determine how States differ in the quality of services to program participants, it is a useful exercise to examine whether such State law choices have any implications for the costs of UI operations. The Macro analysis conducted a correlation analysis to compare the resource requirements (as measured by Minutes per Unit of workload) for key administrative activities between States with and without certain State law characteristics.[25]

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[23] An additional exercise used only NUCs for the 11 States that were "quality" operations in both tax and benefits. In this case, the resulting administrative grants would have been about 20 percent lower than otherwise calculated under AFI.

[24] "Analysis of the Relationship Between Workloads and Administrative Staff Resources in the Unemployment Insurance Program," Crosslin, R., Cook, R., and Nisselson, H., Macro Systems, Inc. and Westat, Inc., August, 1986.

[25] The analysis examined 26 classification variables for State UI laws and regulations.

The study examined the implications of differences in 28 State law provisions (in 1983) involving six broadband administrative functions. Most of the differences were defined as the existence or absence of a particular legal procedure or requirement in determining eligibility, calculating benefits, resolving disputes, or administering tax activities. The existence of law requirements was shown to have a statistically significant effect in a few cases. However, in virtually all cases, the effects are either small relative to other variables, or have been overtaken by State law changes.[26] The results suggested that incorporating State laws in determining administrative funding, even if those laws could be related to the quality of performance, would have very little effect on State allocations.

Although the authors of the Macro study suggested that while they discovered no significant relationships, they believed that their analysis was promising for future research. One improvement would be to use actual cost information as opposed to the MPU data used in the study. The more accurate cost accounting data collected for 1989-92 could be then be applied statistically to updates of the State law data for those years.

V. Lessons on Cost and Quality Relationships from Other Federally-Funded Programs

We conducted a review of several other Federally-funded programs to examine the extent to which analysis has been carried out to estimate relationships between administrative costs and administrative quality. The review mainly focused on programs where the Federal government provides portions or all of the funds required to administer the program.[27] The review also sought out discussions on the extent to which quality is taken into account when funds for administrative activities are distributed.

The review revealed very little in this area. The Federally funded programs examined have well-established allocation formulae for distributing funds, but we found no explicit analyses carried out to evaluate how costs (or funding) relate to the quality of program operations. We found very little evidence that the programs explicitly tie administrative performance to funding allocations.

Some analysis has been carried out on Medicare. The Health Care Financing Administration (HCFA) operates an extensive measurement and monitoring program authorized by Federal

[26] For example, the analysis showed higher costs (MPUs) for State's operating wage request versus wage reporting operations; all States but two have since established wage reporting procedures. Other requirements, such as the availability of seasonal benefits were shown to have a positive effect on costs, however, the Macro authors argue that the effect is so small that it would have little effect on overall costs.

[27] Candidates in this search included the Food Stamp program, the Women Infants and Children (WIC) program, the Disabilities Insurance program under Social Security, Medicare, and others. With the exception of the Medicare program, where fees for claims processing are paid to private contractors, funds for operating these programs are paid to State governments.

regulations for the private contractors that process Medicare claims.[28] HCFA does not directly link claims processing performance to the payment of fees to contractors, though it does have in place certain provisions for penalty and interest when claims are not reviewed by the carrier for quality assurance.[29]

The TMC Study

A contracted study carried out in 1988 and 1989 by Technology Management Corporation (TMC) attempted to develop a measure that incorporates standard HCFA performance measures into an "optimal cost" index to guide funding of Medicare claims processing activities.[30] This optimal cost measure would require the identification of systematic relationships between costs, quality and timeliness. The TMC researchers were unable to find any statistical relationship between these measures and concluded that increases in costs do not result in higher quality and timeliness. Conversely, they concluded, reductions in costs (and funding) would not necessarily be detrimental to quality or timeliness performance.

VI. Lessons for UI Administrative Financing from the Regulated Industries

Summary

Knowledgeable observers of the UI program have noted the similarities between the cost-based systems for determining UI funding levels and the cost-based systems for setting prices in many regulated industries. These observers have further noted that mechanisms for taking into account the level of quality in setting rates for services have already been incorporated into the regulatory schemes for some industries, and that these procedures may be adaptable to the UI program. Consequently, it has been suggested that we investigate the regulated industries for ideas relevant to the development of a performance-based UI funding system.

Not all experts shared an optimistic view of the usefulness of this avenue of exploration. Examining the regulated industries for lessons applicable to UI administrative funding was

[28] See for example, the CD-ROM of HCFA's Laws, Regulations, Manuals, June 1994.

[29] See QA 501, *Penalty for Non-Reviewed Claims*, pg. 15, Notes, HCFA's Laws, Regulations, Manuals, June 1994.

[30] Technology Management Corporation; Optimal Cost of Medicare Claims Processing, Final Report; Report to U.S. Dept. of Health and Human Services/HCFA; 1989.

likened by one subject matter expert, a regulatory attorney, to comparing "apples and bats."[31] However, while it is true that neither the specific measures of quality nor the specific mechanisms used to adjust revenues in these industries are directly relevant to the funding of UI administration, the general nature of these procedures does suggest analogous mechanisms for bringing quality into the UI funding equation.

To identify most of the written documentation relevant to the role of quality of service in regulatory industries would have required a lengthy review of the myriad rulemaking and ratemaking proceedings on file at each regulatory agency. We determined that a comprehensive overview of the same information could be obtained in a fraction of the time by interviewing the regulators who apply the rules on a day-to-day basis and have an institutional knowledge of the regulatory environment. We also conducted a review of theoretical and empirical literature in the economics of regulation field.

This section of the paper briefly describes the prevailing method of regulation in each of the major regulated industries, with emphasis on the role that quality of service plays--or does not play--in each regulatory scheme. Specific State programs in which rigorous methods for adjusting revenue in accordance with quality of service are discussed in more detail. There is little specific discussion in this section of the applicability of these regulatory frameworks to UI, since it is beyond the scope of this paper to develop procedures for performance-based UI funding. However, in the recommendations section of Part VIII, we have suggested one possible application of some of the regulatory procedures discussed below.

To summarize the findings of the investigation, quality of service does not play a major role in the prevailing forms of rate regulation in the United States, nor has it been extensively examined from an empirical or theoretical perspective in the academic literature. In most industries in most jurisdictions, quality of service is either not a standard factor in rate and cost of capital proceedings (see below), or it is discussed, but has little effect on the outcome of these proceedings.[32] There are, however, exceptions, and it is these exceptions that hold some interest for potential designers of a quality-based UI funding system.

Traditional methods of regulation have, until recently, been the same across industries in most of their essential features. Rates are based on costs, including capital costs. Capital costs include depreciation and an allowed return on investment. The allowed rate of return is set at the "cost of capital," or the return that will continue to attract investors, given the level of risk in the industry.

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[31] Martin Gordon, Senior Program Manager for Energy Research & Development at the National Rural Electric Cooperative Association.

[32] For an explanation of the relative unimportance of quality of service oversight in the regulated industries, see Kahn, Alfred E., *The Economics of Regulation: Principles and Institutions*, Vol. 1, Cambridge, MA: The MIT Press, 1993, pp.21-25.

Rates are set in either general rate increase or individual rate cases. In some industries, e.g., railroads, both types of proceedings are used. The allowable rate of return is set in separate proceedings, and then applied to the "rate base"; i.e., firm-wide capital investment, to derive firm-wide capital costs for use in general rate increase cases.

In general rate increase cases, various levels of increase are usually set for several different classes of customer, based on the costs associated with each. These costs include the variable costs of service, which are incurred directly as a result of providing service to each class of customer, as well as a portion of fixed costs, which are allocated to each class, usually on the basis of the identifiable variable cost or the level of usage. The fixed costs, and in some industries, the variable costs, include an element of return, based on the depreciated value of capital equipment and fixed plant used in providing the service (or allocated to the service). The same procedure is used in individual rate cases, with fixed costs prorated to the individual customer.

Interstate rates are set by a Federal agency; intrastate rates are set by each State's public service commission (PSC) or public utility commission (PUC). As would be expected, applicable regulations vary widely from State to State. The specific regulatory environment for each industry is discussed in a separate section below.

Telecommunications

Summary

In the prevailing forms of telecommunications regulation, quality of service is not a standard part of ratemaking, but is investigated if a complaint is initiated.[33] Somewhat ironically, such service quality complaints may actually result in rate increases, at least in the short term, because they may cause the commission to recommend new capital investment that will solve the problem underlying the complaints. The cost of this investment would normally be passed through to the rate-payers in a rate increase.[34] On the other hand, the commission also conducts audits of the companies' investments to determine whether they are prudent.[35]

Interstate telephone and cable television rates are regulated by the Federal Communications Commission (FCC). The FCC regulates long distance and has some authority over intrastate side.

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[33] Raymond Lawton, Associate Director, National Regulatory Research Institute (NRRI), University of Ohio.

[34] Bob Burns, Senior Research Specialist, NRRI. This process is consistent with the argument, supported by some, that quality improvements in the UI program require increased funding levels.

[35] Alan Taylor, Chief, Bureau of Service Evaluation, Florida Public Utilities Commission.

Quality of service typically plays only an informational role in most rate cases.[36] On the other hand, the FCC has established the Council for Network Reliability, composed of industry representatives, to determine how reliability should be measured and to set reporting standards accordingly. At this point, it is not clear whether these standards will be linked to rate levels.[37]

On the State level, quality plays a role in setting the level of compensation for telephone companies, although the importance of this role varies from State to State.[38] In addition, most quality of service standards are actually aimed at cost containment, or efficiency, often compelling the utility to purchase more advanced equipment to reduce costs per unit.[39]

Telephone regulation on both the State and Federal level is currently moving away from the type of traditional rate regulation described above and toward partial deregulation. Specifically, PUCs are allowing rates on business service to be set by competition, while setting price caps on residential service.[40] As the term indicates, the local telephone company may set rates at any level less than or equal to the cap.[41] This procedure is especially well-suited to the telephone industry at the current time, since costs are trending downward.[42] In these hybrid systems, PUCs concentrate on preventing the telephone companies from shifting costs from business to residential customers.[43]

PUCs typically retain authority over quality of service and jurisdiction over complaints under the price cap system, since the legislative mandate is invariably to guarantee "safe and adequate service for just and reasonable rates," or language to that effect.[44] Under some price cap regulation, certain quality standards are set that act as affirmative goals. These include such things as miles of optical fiber cable laid, number of digital switches installed, and failure rates above a certain level.[45]

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[36] Lawton.

[37] Lawton.

[38] Charles W. King, President, Snavely, King Associates, Inc.

[39] Lawton.

[40] Burns.

[41] Victor Gallina, Supervisor-Telecommunications Division, Public Utilities Commission of Ohio.

[42] Burns.

[43] Burns.

[44] Karen Bauer, Editor, *Utility Regulatory Policy in the U.S.*, National Association of Regulatory Utility Commissioners (NARUC).

[45] Greg Sidak, American Enterprise Institute.

Sometimes quality of service is regulated in a very broad way. In New Jersey and Rhode Island, for example, the PUCs have issued orders to the effect that, if quality of service is not kept up, the PUC will cancel the rate reform itself.[46] In other cases, quality of service is linked in a formulaic way to the rate of return or even the rates themselves. The Ohio PUC, for example, has proposed an *automatic* quality of service adjustment clause. In the proposed system, if the utility achieves the standard, it receives more money.[47]

In most States, there is constant feedback regarding customer complaints in the billing procedures. In some States, service quality is determined by pulling and tallying customer complaints by type. If the number of complaints decreases, then the rate of return is increased, and vice versa.[48]

Florida: An Example of Rigorous Performance-Based Regulation

Florida telephone regulation provides a good example of a rigorous procedure for measuring quality of service, although the link to rate adjustment is something less than rigorous.[49] On the other hand, there is a "rates of service" law in Florida, which allows the State to penalize the phone company through reducing its allowable rate of return. In addition, the company has the burden of providing service in the most efficient manner. This same system was in place before the split-up of AT&T.[50]

In Florida, volumes of information on telephone service quality are made public. The PUC subsequently provides independent evaluations of operations, and sets rates accordingly. Both the customers and the company provide evidence on the level of service quality, resulting in contradictory information. The PUC provides a neutral, independent view, based on consideration of all evidence.[51]

Significant State resources are devoted to this oversight process. The Commission tests for 78 items measuring quality, based on rules in place at the Commission. For some of these items, engineers with automated testing devices perform field tests.[52]

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[46] Lawton.

[47] Lawton.

[48] Lawton.

[49] Taylor.

[50] Taylor.

[51] Taylor.

[52] Taylor.

Examples of these standards are:

- Service started within three days of request;
- Repairs within 24 hours of a request;
- Name in directory within 24 hours of installation;
- Calls from point A to point B are completed without blockage 95 percent of the time;
- A dial tone is received within three seconds 97 percent of the time;
- An operator comes on line within ten seconds 80 percent of the time; and
- Hearing impaired receive TDD service.

Using measures such as these, Florida has quantified how service quality is taken into account. Traditionally, violations have always been found. In previous years, the evaluation of these violations was based on the judgement of a staff member, who would determine whether the violation was something major, or "not too bad." Over the years, this subjective evaluation was changed to a standard-based test, which requires specific action if the test is not passed.[53]

Today, the telephone company is penalized for inadequate service levels in the allowable rate of return. To identify the appropriate cost of capital, the Public Utility Research Center developed a survey that determined which service rules are important to consumers and weighted each standard accordingly. In this way, the measures can be combined, resulting in a single-number overall score based on all 75 "baseline" standards.[54]

The utility may fail some standards, but may obtain a score that exceeds other standards, possibly offsetting the margin of failure on other items, so that the overall score may exceed the minimum acceptable. The intended result of this type of test is that the utilities will focus on the most highly weighted problem areas, resulting, in turn, on the most beneficial use of resources.[55]

The local phone companies' rate of return has been affected by this system. In addition, phone rates can be directly affected by a finding of inferior quality. Southern Bell is one major company not strictly regulated by rate of return. Southern Bell is a large company that serves many areas of the State of Florida. Since the service evaluations are done on a local basis, rather

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[53] Taylor.

[54] Taylor.

[55] Taylor.

than statewide, Southern Bell will sometimes pass the test in all areas but one. In this case, Southern Bell is allowed to raise its rates in all but that area, in which no increase will be allowed.[56]

Ohio: An Automatic Quality-Based Rate Adjustment

Historically, there have been minimum telephone service standards in Ohio, consisting of basic criteria that local telephone companies must meet. For example:

- A maximum of 1 percent of calls from point A to point B not completed due to network block during peak hours; and

- An operator must answer within 20 seconds 90 percent of the time.[57]

Traditionally, if the violation of service standards is due to extenuating circumstances, and is not a continuing problem, it does not affect future rates.[58]

However, recently Ohio Bell has proposed an alternative regulatory scheme for local service involving a rate cap plan. Under this plan, the cap would be adjusted periodically by an index incorporating price inflation, productivity, and quality of service.[59] As in most price cap schemes, this index would be applied automatically. As such, this is about as rigorous a form of quality enforcement as could be designed.

Increases would be adjusted based on meeting minimum telephone service standards. If the company met all of the standards 100 percent of the time, the company would be rewarded by an increase in the band around the price cap. If the company missed one or two of the standards for a certain number of consecutive months, the band would be narrowed and the company would lose its ability to adjust the rate. This proposal currently remains in hearings.[60]

The price cap index includes inflation, a productivity factor, and exogenous factors. The quality of service factor is one more factor proposed to influence price cap index. There are limits on increases for individual services, especially in monopoly markets. There are three to four

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[56] Taylor.

[57] Gallina.

[58] Gallina.

[59] Gallina.

[60] Gallina.

"baskets," based on types of service (e.g., residential, business), each with different constraints and, thus, different total indices.[61]

Other Rigorous Forms of Performance-Based Regulation

Other investigation revealed that some States operate "earnings sharing plans," under which the telecommunications firm keeps extra money if it exceeds minimum telephone quality standards, typically based on four to five measures.[62]

Telephone services in foreign countries may provide the best examples of tightly controlled service quality and quantifiable effects on rates. In many countries there was privatization of a State-run phone company. When this occurred, there was typically a period during which the newly privatized firm enjoyed monopoly power, and during which they were required to meet certain investment objectives, as well as meet certain safety requirements.[63]

Electric Power

Summary

Power that is transmitted across State lines is regulated by the Federal Energy Regulatory Commission (FERC). Power transmitted within each State is regulated by the State PUC.

Quality of service is generally more of an issue in communications than in electric utility rates, primarily because quality of electric service, per se, is not highly differentiated. If the customer has power, there is usually no dispute relating to the quality of the power itself. Quality of service is defined primarily in terms of outages, i.e., complete lack of service. Nevertheless, similar to telecommunications regulation, the importance of quality of service in ratemaking and the particular mechanism by which rates are affected varies widely from State to State.

By way of illustrating electric utility customers' ambivalence toward quality of service, one SME[64] cited an Edison Electric Institute (EEI) survey of customer satisfaction in which customers were asked if they would be willing to pay more for higher quality service or if they

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[61] Gallina. For further information, see In the Matter of the Application of the Ohio Bell Telephone Company for Approval of an Alternative Form of Regulation, Case No. 93-487-TP-ALT, PUCO Staff Report of Investigation, filed March 25, 1994.

[62] King.

[63] Sidak.

[64] Gordon.

would prefer to pay less and accept lower quality service. The results showed that customers were neither willing to pay more for higher quality service, nor accept lower quality. Contrary to expectations, they were not willing to pay more to avoid a higher level of interruptions.

In the electric utility industry there are certain standards for the quality of service from which no utility deviates; there is a minimum quality of service, since service is defined as receiving power, and quality of service is defined strictly in terms of power outages. However, even within these parameters, there are ways in which service quality is involved in setting rates. For instance, if large industrial customers have processes that can be interrupted without having a major affect on business, they can get lower "interruptable" or "conditional" rates.[65]

If there is a situation where the utility is generating at peak levels, and it is necessary to cut back some of the usage, there are mechanisms for cutting back the power to such contract customers. This can be done either through a simple phone call or through some more sophisticated method.[66]

On the residential side, lower rates are offered to those customers willing to install radio-controlled interruptable water heaters and air conditioners, under the same principle. Anything that gives the power line utility more control over the amount of power going towards end-use will result in a rate break.[67]

Traditional Ratemaking in Electric Power Regulation

In traditional cost-based ratemaking, rate base capital facilities are allowed a rate of return to determine the overall cost used in setting rates. This rate is supplemental to that authorized based on variable expenses, such as fuel and variable operations and maintenance (O&M). The investment in power generating facilities is allocated across customers, resulting in a prorata element of return in each rate. Fixed portions of costs such as maintenance are also allocated across customers.[68]

Users are divided into broad customer categories based on characteristics of use. Large customers, such as aluminum smelters, receive service on a contract basis; however, these contracts are subject to review and approval by the PUC. Typically, a general rate case, in which

[65] Ken Linder, Director of Rates and Regulation, Edison Electric Institute.

[66] Linder.

[67] Linder.

[68] Linder.

rates are set on each broad customer class, is held when a new power generating facility is put into service. During such proceedings both rate design and rate of return are addressed.[69]

The Prevailing Quality of Service Mechanism in Electric Power Regulation

Quality of service is measured as the number of average outage hours per customer. A national organization develops these standards. If a company's average outage is less than or equal to the national standard, its performance is considered acceptable. If the company averages more than the national standard for outages, this is considered a problem, and an examination of the reasons for this excessive outage is undertaken. In particular, investigators look for weather-related outages versus negligence on the utility's part. If negligence is found, it is typically reflected in the utility's rate structure.[70]

The company's O&M practices are examined for possible areas of improvement that could affect service. The PUC targets certain suspect areas. For instance, if the utility operates in a densely forested area, where there might be an ongoing problem with tree limbs falling on the power lines and causing outages, the PUC may order the utility to institute a tree-trimming program. The cost of the new program would be added to the allowable costs of service that can be recovered from the ratepayers. The PUC might also require inspection of poles and facilities. It could also disallow certain costs it found to be spent on unnecessary items, so that such improper expenditures would, in effect, be paid for out of the shareholders' pockets.[71]

The general way in which the allowable rate of return is set begins with a "test year," which is typically the most recent 12-month period prior to filing of evidence. The total allowable costs for the rate year are based on those incurred in the test year, adjusted for "known and measurable changes." The commission must determine whether the test year was a representative year and adjust it--up or down--for anomalies.[72]

Rates are set on a "cost of service" model; except for fuel costs, which are passed through in the special "fuel clause." The fuel clause is based on projections of fuel costs and sale of electricity in kilowatt hours. Fuel costs are separated from the rate base.[73]

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[69] Linder.

[70] Danny Bivens, Fuel Analyst, Texas Public Utilities Commission.

[71] Bivens.

[72] Bivens.

[73] Bivens.

One SME interviewed for this investigation[74] felt that one hidden quality control issue involves these automatic fuel adjustment clauses, which, according to this SME, have the unintended effect of getting the utilities "off the hook" for quality control as far as fuel efficiency is concerned. The utilities are allowed to recover--without a hearing--the cost of fuel, regardless of whether the utility is taking the proper steps to minimize fuel consumption through proper maintenance and other procedures.

However, fuel costs are examined in "fuel reconciliation proceedings," where the utility is required to give evidence that it is burning efficiently. In addition, every three years, all fuel contracts are reviewed for prudence.[75]

On the other hand, the quality of service measures do not generally play a role in setting the allowable rate of return for electric utilities. Nor is quality of service looked at closely in most big rate cases.[76]

Quality of service in the electric utility industry centers on outages, which are measured in several categories, including:

- The number of rolling blackouts to prevent brownouts;
- The number of brownouts;
- Emergency response time to storms; and
- The number of customers affected by emergencies.[77]

In the electric power industry, the markets are segmented and the product is differentiated. Thus, the standards for service quality differ according to the market segment. The quality of power itself is an important product differentiation. For example, firms using sensitive electronic equipment would have a greater than average need for a minimal number and size of volt lags, surges, and spikes.[78]

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[74] King.

[75] Bivens.

[76] Bivens.

[77] Burns.

[78] Burns.

New Trends in Electric Utility Regulation

The electric utility industry and the nature of its regulation are undergoing significant changes. These changes are having concomitant effects on the way that service is evaluated and interpreted. For example, the practice of "wheeling," or one utility buying power from another off the "grid," of interconnected power lines, has opened a wholesale power market and retail markets may follow.[79]

Retail wheeling entails the buying of power by a customer from a utility other than the host utility and buying only transmission from the host utility. As transmission separated or "unbundled" from generation, there is more competition on the wholesale side providing bulk power. Traditionally, the customer purchased generation as well as transmission and distribution in a single lump sum from a single utility. New methods of compensation are focusing on paying for each of these three services separately. As a result of this new competition to provide wholesale power, the generation side is moving away from traditional cost-based rates toward market-based rates. In contrast, transmission is still a monopoly.[80]

Also, as in the telecommunications industry, there are increasing calls for the institution of price caps on residential customers. However, unlike in the telecommunications industry, utility costs are *not* trending downward.[81] At the time of this writing, only a handful of States had either instituted, or were in the process of considering, residential price caps on electric service.[82]

Performance-Based Ratemaking

Performance-based ratemaking, which is a type of price cap regulation, is another new development in electric utility regulation that is the best example of how quality of service can be used as a factor in setting rates. In this type of ratemaking, variable expense and rate of return are projected, with a portion of capital expenditures amortized through depreciation. The aggregate of these expenses is the unadjusted price cap. This cap is then adjusted based on a formula incorporating inflation and measures of service quality. Linking maximum reasonable rates to performance in such a systematic way provides the consumer protection that makes it feasible for regulators to allow the utilities pricing flexibility. Rates can be set at any level less-than-or-equal-to the adjusted cap.[83]

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[79] Burns.

[80] Linder.

[81] Burns.

[82] Linder.

[83] Linder.

These price caps are adjusted annually by the rate of inflation, adjusted for the industry-average change in productivity. This provides utilities with the opportunity to increase their productivity by greater than the industry average, returning the difference to shareholders. In some price cap schemes, quality is calculated based on a wide variety of measures, including customer complaints, outages, worker safety, and a range of other factors. How this is used in ratesetting and setting of price caps differs by program, each of which is unique.[84]

An example of such a program is that recently proposed by San Diego Gas & Electric, which is a performance-based system involving a regulatory incentive mechanism keyed in part on customer satisfaction, as well as reliability and safety (reliability level referring to outage of service).[85] New York is also planning a move to performance basing in the future.[86]

The best example of this type of performance-based ratemaking is in Mississippi, where two separate utilities are currently using this method. One of the two companies has been using the system for 3-4 years. The performance evaluation programs in Mississippi stabilize baseline return on equity, then adjust it based on a composite index of performance ratings in seven different areas. Several of these areas relate to quality of service. In this way, the financial return to shareholders is directly tied to performance measured by both efficiency and quality.[87]

Niagara Mohawk Power Corporation: An Example of Customer Service Incentive Rates

In 1991, Niagara Mohawk Power Corporation (NMPC) received approval for its "Measured Equity Return Incentive Term," or MERIT, which is part of NMPC's Management Self-Awareness project. The customer service goals for this project are:

- Reduction of complaints to the PSC;
- Reduction of layers of management;
- Implementation of certain other procedures to produce savings;
- Generation goals;
- Reduction of corrective maintenance work requests; and

[84] Linder.

[85] Edison Electric Institute, Finance, Regulation and Power Supply Policy Group, *Types of Incentive Regulation: A Primer for the Electric Utility Industry*, Washington: Edison Electric Institute, April 1993.

[86] Linder.

[87] See EEI, *Types of Incentive Regulation.*

- Outage management goals.

Under the project, savings are committed to customers, or "ratepayers" well before they are realized, resulting in the risk of underperformance being borne entirely by NMP's shareholders. The assumed annual savings for fiscal years 1991, 1992, and 1993 were $5 million, $35 million, and $46 million, respectively.[88]

Mississippi: An Example of Multi-Standard Performance-Based Ratemaking

Mississippi Power Company's (MP's) Performance Evaluation Plan, adopted in 1986, provides both rewards and penalties using a sliding-scale mechanism. In this plan, the company's performance is measured in seven areas:

- Construction cost management;
- Load factor improvement;
- Customer satisfaction;
- Plant availability;
- Residential rate levels;
- Employee accident levels; and
- Service reliability.

The utility's performance rating is determined by assigning scores in each of the above seven measurement factors and then weighting each performance factor to derive a weighted average index. If the actual rate of return is more than two percent above the benchmark rate, revenues are adjusted downward; if the actual rate of return is more than two percent below the benchmark return, revenues are adjusted upward. The extent of the adjustment depends on the performance rating.

The project incorporates a quarterly determination regarding whether the rates will be changed. A group of utilities with the same Standard & Poor's bond rating as MP is used to derive an average return on common equity (ROE) for use in the rate increase.[89]

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[88] *Ibid.*

[89] *Ibid.*

Natural Gas

Summary

Natural gas that is transported across State lines is regulated by the FERC. Gas that is transported within each State is regulated by the respective State PSC/PUC.[90] Like electric utilities, quality of service by gas utilities focuses on emergency and crisis management; either the customer has service or there is a severe drop in pressure, preventing the delivery of gas altogether. The latter situation occurs only in extremely cold weather, such as during the winter of 1978, when not enough gas was being delivered through the lines to many areas.[91]

The Role of Quality of Service

Management efficiency (or inefficiency) in the gas industry is rewarded (or punished) by an increase (or decrease) in the allowable rate of return. The level of management efficiency is measured based on a Management Efficiency Report filed by individual employees and customers.[92] The number of complaints filed is compared to that for other utilities and to other States. The amount by which the rate of return is adjusted is subjective, depending on the number and type of facts before the State or Federal regulatory commission that has authority. However, in gas regulation, quality of service plays a role in any decision-making process.[93]

All State customers have the opportunity to complain of poor quality, and the utility is obligated to investigate each complaint. For instance, if someone smells gas, and the utility fails to check this report, this is taken into account in determining the quality of service. This, in turn, can affect the rate paid. For example, in the State of Iowa, when a utility files for a rate increase, there is a public hearing, providing an opportunity for consumer input before the board regarding the quality of service. Moreover, the Consumer Advocate, a State attorney representing the ratepayers, may testify before the board on management efficiency.[94]

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[90] Recently, FERC rulemaking proceedings (Cases No. 436/636) have opened access into the gas field. Large industrial customers can shop for local distributing companies (LDCs).

[91] Burns.

[92] Management audits are also performed to determine whether the utilities' management practices have been "prudent" based on a set of predetermined standards. In addition, special "prudence reviews" are undertaken of investments after they are made to determine what should be included in the rate base.

[93] William D. Adams, Supervisor, Gas and Water Rates Section, Utilities Division, Iowa Utilities Board.

[94] Adams.

The utility can be penalized in ways other than the reduction of the allowable rate of return. If it is found that the utility built something to specifications that went unnecessarily beyond those required for providing safe and efficient service to current and future customers, or invested in plant or equipment it did not need to provide quality service, this cost or investment can be disallowed. This can be anything in excess of the least-cost way of providing adequate service.[95]

Any lack of service would be addressed during the rate-setting proceedings. The rate of return on equity is normally set equal to that in other industries having comparable risk. This rate can be adjusted to reflect management performance and efficiency, as measured by quality of service.[96]

The Postal Service

Summary

While not strictly a regulated industry, the postal service shares characteristics with regulated industries, in that its rates are subject to oversight by a Federal commission. Service quality measures, primarily delivery times, do play a role in setting postal rates, albeit a largely informational one. Postal rates are set as described below.

The postal service applies to the Postal Rates Commission for rate increases. The Postal Rate Commission has ten months to conduct a hearing and make a recommended decision on the rate increases on each class of mail.[97] The Commission's recommended decision is then submitted to the Board of Governors of the Postal Service for review. The Board has the power to overturn any of the Commission's recommendations.[98]

The only way that the Postal Rate Commission can reduce the overall revenue request is to establish that the Postal Service's estimates of the elasticity of consumer response to postal rates

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[95] Adams.

[96] During these proceedings, the utility maintains that additional capital expenditure is necessary; i.e., that the lack of service is due to undercapitalization.

[97] The Commission may not change the aggregate dollar amount of recovery, i.e., the total increase in revenues (the sum across all classes of mail of revenues resulting from the various class rate increases). The Commission rarely attempts to disallow increases altogether. However, it did so on at least one occasion, in which the disallowed amount consisted of $500 million in "contingency allowances" that the Postal Service allotted itself. The Board of Governors overturned this reduction, despite its relative insignificance in comparison with the aggregate Postal Service revenues of some $36 billion. In the postal rate hearing currently under way, the Postal Service has requested its first across-the-board increase, eliminating all dispute as to the rate structure.

[98] King.

are incorrect. The Commission has challenged the elasticity forecasts on occasion, but the resulting reductions have been in the range of $10 million, minuscule in proportion to total revenue.[99]

The primary function of the Postal Rate Commission hearings is to determine the rate *structure*, i.e., the way in which an overall rate increase is to be distributed among the various classes of mail. The recommendations of the Commission with respect to the rate structure are not automatically adopted by the Board of Governors.[100]

Rates are essentially cost-based, with every class required to cover at least its "attributable," or variable, costs of service. Attributable costs in the postal industry average 60 percent of total cost. Unlike other cost-based pricing, however, there is no cost of capital built into the rates. The only capital cost included is depreciation. No return on a "rate base" is incorporated.[101]

The cost of labor makes up approximately 85 percent of all fixed, or "institutional" costs. City delivery carriers and mail handlers alone make up around 70 percent of these costs, with the only other appreciable costs being those of transportation.[102]

In the past, nonprofit mail did not have to recover its attributable cost, and the Postal Service received appropriations from Congress to make up for any revenue shortfall. However, all classes of mail are now required to pay compensatory rates, and Congress has cut off all appropriations to the Postal Service.[103]

Rates within each class are set according to rules that are both arcane and complex. For instance, second class mail, consisting of periodicals, is divided into advertising content, which carries a distance-based rate, and editorial content, which is flat-rated. Thus, for each piece of 2nd class mail, there is a "piece charge" and a "pound charge," the latter fluctuating with distance.[104]

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[99] King.

[100] King.

[101] King.

[102] King.

[103] King.

[104] King.

The Role of Quality of Service

In every rate hearing, a witness representing the Postal Service typically discusses quality of service in terms of percentage of on-time deliveries. However, while one might assume that inferior service, as measured by a low percentage of on-time deliveries would result in a reduction in the allowable amount of increase, the Postal Service argues precisely the opposite; i.e., that it cannot provide adequate service because it is not receiving adequate funding. Regardless of such debate, the primary SME interviewed for this investigation[105] could not recall testimony involving quality of service ever having an affect one way or the other on the amount of increase.

Railroads

Summary

Intrastate railroad transportation of freight is regulated by State PUCs, PSCs, or railroad commissions. Interstate rail transportation of freight is regulated by the Interstate Commerce Commission (ICC). In the 1980s, all States were required to either turn intrastate regulation over to the ICC, or revise their regulations to be consistent with those of the ICC. Rates are normally set by the private railroad companies. However, shippers may file rate complaints with the ICC if they believe their rates are unreasonable. ICC rate reviews are performed in two "phases." In the initial phase, the ICC makes a determination of "market dominance." A finding of market dominance essentially means that the railroad holds a monopoly over the subject transportation and is a prerequisite for moving into the second phase for a "rate reasonableness" determination.

A finding of market dominance requires that the disputed transportation pass three tests: it must have a rate-to-variable cost ratio above a specific threshold, currently 180 percent; there must be no viable "product competition"; and there must be no viable "geographic competition." Product competition means that the shipper could substitute a different product for the commodity at issue. Geographic competition means that the shipper could purchase the same product from a different source from which the product could be transported over a different route to the same destination. The rate-to-variable cost threshold is a proxy for the level of intra- and intermodal competition, and if the disputed rate exceeds the threshold it creates a "rebuttable presumption" that there is no viable competition for the transportation of the subject commodity from the subject source.

In each phase of an ICC rate complaint proceeding, each side files legal argument and testimony by expert economic and operational witnesses. Complaint proceedings are usually heard by Administrative Law Judges (ALJs); however, occasionally the Commissioners themselves will preside over a case. Following consideration of the evidence in the initial phase, the ICC issues

[105] King.

an interim decision on market dominance. The parties may appeal the decision back to the ICC. If the ICC finds market dominance in the case, it proceeds to the second phase and evidence on rate reasonableness is heard.

ICC ratemaking guidelines for most "noncompetitive" commodities set the maximum reasonable rate at the "stand-alone cost" of the service, defined as the cost of providing the service efficiently in the absence of all other traffic; i.e., the full cost of service under maximum efficiency and with no cross-subsidization in a contestable market. As such, the stand-alone cost is a theoretical construct that, for example, must have all costs associated with barriers to entry netted out of it. If the ICC finds that the rate at issue exceeds the stand-alone cost of service, it will issue a decision finding the rate to be unreasonable and prescribing a new rate equal to the stand-alone cost. The ICC will also award reparations with interest for any traffic previously transported under the unreasonable rate.

The Role of Quality of Service

Quality of service plays a relatively small and indirect role in ICC ratemaking. The only measures of quality that are significant to the shipper are 1) reliability and timeliness of service and 2) the level of loss and damage to the shipments. Rather than providing the basis for some penalty or reward, respectively, for inferior or superior service, these measures of quality affect the maximum rate level directly in ICC regulation. Since, as a practical matter, most ICC rate complaints involve bulk commodities, loss and damage is of minimal importance, although it is incorporated into the maximum rate as an element of stand-alone cost. The timeliness measure can have a more significant effect on the maximum rate.

Because stand-alone cost represents the cost of providing service at optimal efficiency, it must be based on the fastest feasible shipping time. For the regularly scheduled, dedicated trains that are the typical subject of rate complaints, the key related variable is the average time required for the train to complete a cycle. Cycle time affects the cost of service primarily through the amount of "rolling stock" (locomotives and railcars) required to provide the service. The longer the cycle time, the more rolling stock is needed to ship a given annual volume of any commodity, requiring a correspondingly larger amount capital cost. If the shipper can show that cycle times faster than the actual are achievable, the ICC will incorporate the lower costs associated with these faster cycle times in determining its cost-based rate.

Railroad mergers and acquisitions are also subject to ICC approval. One of the primary criteria for approval of such consolidations is their projected affect on the overall service quality of the national rail system. If the ICC determines that the net effect of the proposed action would be to enhance overall service quality, it will be inclined to approve the proposal, all other things being equal.[106]

[106] Frank S. Harris, II, Senior Associate, Peabody & Associates.

VII. Lessons from the Private Insurance Industry

It has been suggested by knowledgeable observers that the insurance industry is a private analog to the UI program. Since both are insurance, they share key elements, notably claims processing. The functions performed by private health insurance companies, in particular, are especially close to those performed for UI, since these companies, like SESAs, process insurance payments and administer benefits. This section of the paper was undertaken on the basis of this observation, with expectations that the insurance industry might have established procedures for improving customer service while minimizing costs and that any such procedures might be applicable to the UI program. Our focus was on methodologies used by private insurance companies in budgeting for claims processing, which we felt to be analogous to methods for funding UI administration, which consists primarily of processing claims for benefits and administering payments (taxes) to the insurance program.

Claims Processing

Availability of Information

The SMEs contacted during the course of this investigation[107] were unanimous in independently stating that neither specific information on budgeting for claims processing in the insurance industry nor any studies on the relationship of cost to quality in private insurance claims processing is available. There were two interrelated reasons given for this lack of information.

The primary reason given was that companies in this business are so competitive that they would not cooperate in any such study because of the risk of revealing either their internal costs or their budgeting methods to their competitors. The second explanation, cited independently by two SMEs representing different lines, is that the industry is extremely sensitive to antitrust laws,[108] and sharing proprietary cost information of this type could be construed as an attempt at moving competing firms toward a standard claims processing cost, which could, in turn, result in a standard price, tantamount to collusion.[109]

[107] Fyffe, Johnson, Dokter, Lennan, Markham, and Schroeder; see appended SME list.

[108] Anne Lennan, Director of Federal Affairs, Society of Professional Benefit Administrators.

[109] Bill Schroeder, Vice President--Claims, Alliance of American Insurers.

Administration of Medical Benefits

We were able to obtain some useful information on third party administrators (TPAs) of medical benefits for self-insured companies. TPAs probably provide the clearest private sector analog to the benefit activities of UI administration, since they exclusively process claims for benefits under a given contract. Thus, these activities and attendant costs are separable from other functions that might be less analogous to those under UI.

The bases for the fees that these companies receive are "all across the board," from number of claims processed to number of participants in the plan. However, the most prevalent methodology is a flat fee per participant. The TPAs bid on medium-term contracts, usually on a charge per participant basis. A typical pattern is a low basic first year charge, with a rise in prices for auxiliary tasks like reporting in the second year.[110]

Quality in benefit administration is measured by timeliness and accuracy. Both of these measurements are integrated into the "performance guarantees" that have been included in some TPA contracts in the past. Performance guarantees typically set a target for the percentage of claims processed accurately within a given time limit. According to one SME,[111] these clauses were a passing trend that peaked a couple of years ago and are now falling back out of use. The same SME stated that it is the accuracy of the benefit payment, rather than the time required for processing the claim that can cause problems. At the same time, she stated that currently it was not typical for TPA contracts to include guarantees on accuracy.

Nevertheless, accuracy is monitored closely. Some TPAs are hired solely for the purpose of doing independent "utilization," or "case management" reviews, which are audits in which the TPA goes back and reviews how the claim was processed after the fact to ensure that the claim was properly paid. This is done concurrently with the original TPA continuing to process claims for the client. In fact, several TPAs can be working for the same self-insurer on different types of policies.[112]

In regard to the level of compensation for claims processing, according to a spokesperson for a TPA association,[113] some members barely break even on claims administration, some depending on profits earned on selling other services to make up for the low margin on claims administration. Many TPAs also are agents for life insurance and disability policies. In fact, many TPAs entered the claims administration business when they were selling such other types of insurance to medically self-insured companies, who complained about the poor quality job the

[110] Anne Lennan, Director of Governmental Affairs, Society of Professional Benefit Administrators.

[111] Lennan.

[112] Lennan.

[113] Lennan.

medical insurance companies were doing on their claims administration and requested help from the TPAs.[114]

TPAs offer bids according to their assessment of competition, tempered by knowledge of their costs. Because of the highly competitive nature of the benefits administration business, TPAs are probably charging processing rates just above variable unit costs.[115]

We received somewhat varying information from a representative of self-insured companies that use TPAs.[116] According to this SME, the industry assigns fees for the processing of health claims on three different bases:

- Percentage of dollar amount of claim, as filed;
- Percentage of dollar amount of reconciled claim; and
- Forecast number of claims based on past experience.

This source estimated that, for example in California, the percentages of the dollar claim amounts ranged from five to seven percent.

Factors Complicating Evaluation of the Relationship between Quality and Cost

SMEs emphasize that the insurance industry essentially consists of two different sectors, the health and life insurance industry and the property casualty industry. The processing of claims in these two sectors is completely different.[117] Therefore, any analysis of how costs and quality are related needs to evaluate them distinctly.

Furthermore, the cost of claims processing is deceptive, because different firms define this cost differently. Some companies charge a low amount per participating employee and charge more for consulting services that are provided later, but which are a necessary part of the process. Other firms charge higher amounts per head, but charge low amounts for related "overhead" services. Also, there are numerous other variables that would have to be accounted for in a cost

[114] Lennan.

[115] Lennan.

[116] Judi Dokter, Employee Benefit Consultant, Self-Insurance Institute of America.

[117] Jim Markham, General Counsel and Vice President-Personnel, American Institute of Chartered Property and Casualty Underwriters.

to quality study. One would have to identify the factors that are considered important for the specific study.[118]

In addition, one SME[119] warned that any study examining the cost accounting principles behind claims processing budgeting would tend to be misleading, because the comparisons would be of "apples to oranges" because different insurance companies have different mixes of products. One major factor in such differences would be the mix of group and individual policies, as well as the extent of the coverage, with some policies including presumably time-intensive pharmacy claims.

Generally, SMEs report that there are no necessary correlations between cost and quality. They emphasize that such measurements would depend on measures of cost and quality, which would be very difficult to define in a complex industry. The SMEs stated that the performance guarantees included in insurance policies provide one type of quality measurement. These clauses usually involve agreement to pay customers (insurees) within a certain period of time. SMEs did report that, in the property/casualty business, insurers carry out case-specific internal audits that take into account quality of service.[120]

Measuring Quality of Service

In residential home insurance, customer service is measured by speed, and the quality of claims processing is evaluated in two ways:

- Statistical analysis, in which the average "life-span" (processing time) of claims is examined and trends in this average are tracked; and

- File-specific analysis, in which a sample of claims is examined individually and claim life-span and amount paid are evaluated based on the manager's familiarity with the specific type of claim.

The insurance firm will plan future action (including corrective action and budgeting) on the basis of results of these analyses. However, the major way this affects budgeting depends on assumptions regarding how processing would be affected. If quality is negatively affected because claims adjusters are ignorant of proper processing procedures, then overall costs would not necessarily be affected; increased training would be instituted and some adjusters might be

[118] Lennan.

[119] Kathleen Fyffe, Director-Payment Systems, Health Insurance Association of America.

[120] Markham.

replaced. If, on the other hand, the increased time per claim were due to understaffing, then the budget might be increased to hire new claims adjusters.[121]

Regulation

In addition to its similarities to UI administration in terms of claims processing, the insurance industry is also regulated, and some information on the role of quality of service in this regulation was picked up as a secondary issue during the course of investigating insurance as a private analog for UI. In fact, it was easier to uncover information on insurance regulation than on insurance claims processing for the reasons discussed above.

The precise method of regulation depends on the line of insurance (e.g., property, health) and the State. There is generally some type of approval process. The insurer must file a rate justification. The State insurance department will review this filing and may reject it if it fails to meet certain criteria. These criteria vary from State-to-State and among insurance lines.[122]

Although it is unusual for regulators to set rates themselves, in a few States where unusual circumstances exist, such as a lack of competition, or historical difficulties, this may be done for a particular market. In some lines, rates are not reviewed at all. In some lines in some States, settlements paid out must constitute a minimum percentage of premiums paid in, with 60 percent representing a typical standard.[123]

All sources agreed that quality of service, however measured, does not play a role in setting or approving rates. On the other hand, it was noted that property and casualty insurers are subject to "market conduct examinations" in every State. Every State sets a standard for speedy investigation and payment of claims, typically a 30-day maximum. If an insurance company misses this deadline on even a single claim, it can be fined and is even subject to a "bad-faith" lawsuit.[124]

It was argued that these deadlines sometimes prevent a thorough investigation from being completed and, thereby, unwittingly aid insurance fraud. Noting the parallel to UI BPC and QC, we asked industry SMEs whether private insurance companies performed any retroactive review of paid claims to check for the type of fraud mentioned. The answer was that the industry did not have the resources or the manpower to assign to this task. One particular SME stated that

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[121] Markham.

[122] Caroline Johnson, General Counsel, National Association of Insurance Commissioners.

[123] Johnson.

[124] Schroeder.

private insurance companies rely on their claims adjusters to do an accurate job the first time around.[125]

VIII. Conclusion

The above review suggests that the development of a performance-based system of funding UI administrative activities is a complex one that will require extensive additional analysis. Our examination of literature on the UI system and consultation with UI experts suggests that there are as yet no identifiable, systematic relationships between cost and quality that can be exploited in revising administrative funding formulae. However, it appears that the analysis carried out in this area can be enhanced. Review of other Federally-funded programs, regulated industries, and the private insurance industry appears to offer a similar conclusion that there are no identifiable cost-quality relationships in the major activities carried by those industries. Also, the review discovered no formal theoretical attempts in the academic literature that would lend itself to application to the UI program.

Our review appears to suggest more strongly that performance improvement initiatives should be instituted that encourage improvements in both quality and efficiency. The UI quality measurement and enhancement programs in place and being enhanced at the Federal level point to a possible incentive-based funding process that would encourage improvements in State performance. A review of how performance is linked to the rate structures in regulated industries suggests that this area is promising.

A Performance-Based Funding System

The review offers ideas on how an improved UI funding system could be established that would budget administrative activities in accordance with the various functions defined by the UI program's public service mission. Under this funding system, budget requirements and funding requests to Congress would be developed from a systematic study of the resources required to perform at Federally-defined standards of performance that do not interfere with the operation of State laws. Funding levels and allocations would provide incentives and resources for improvement of efficiency and quality of performance.

One approach would be to establish an annual funding level for administrative operations that would be sufficient to fund State operations. This level could be established using the proposed AFI methodology, the current system methodology, or some other approach. States would be given bottom line authority on allocating the funds to various activities. States would be allowed virtually unlimited carryover rights, meaning that greater efficiencies in operations resulting in surpluses could be carried over to future years and expended at State management discretion.

[125] Schroeder.

The States would be encouraged to spend any surpluses on items such as automation or management/worker bonuses.

Under the revised program, national quality standards would be established using key standards already developed in the existing QA, QC and, Data Validation programs and augmented under the PMR and PES programs. Funding would potentially be affected by a penalty/incentive rate system that altered funding levels per unit of workload (after a specified period of attempted remedial action or improvement) on a graduating scale, according to the degree of noncompliance or improvement. This approach would obviously vary from the current system's "death penalty" approach where administrative funds can potentially be withheld completely if a State does not meet accepted standards.

An improved funding system might also incorporate a TQM approach, in which minimal standards of administrative performance are attained, but continual improvements in performance are encouraged as well. Work underway in connection with the PMR and PES initiatives has a goal of establishing measurement systems that would facilitate the establishment of a continual improvement system.

The revised system would be designed to provide incentives at the State level for both improved efficiency and quality. This system would allow State administrators full discretion to manage their programs in whatever manner allows them to achieve the quality standards. Such flexibility would be crucial in an era when continual changes caused by automation, organizational changes, new State and Federal laws and programs, and a changing labor market impose constant challenges to the UI program.

Our review of regulated industries suggests numerous potential procedures for taking into account quality of service in funding SESAs for UI administration. The general idea would be to adjust funding based on the level of quality. However, considering the number of currently unrelated programs for measuring different aspects of UI administrative quality, a useful model for quality measurement would seem to be that used by Florida and other State PUCs to measure telephone quality. Specifically, this would be an overall quality index equal to the average of several measures of quality weighted according to the relative importance of each measure in the mix. Relative importance for the purpose of weighting the respective measures of quality could be defined in numerous ways, both subjective (e.g., importance to the claimants, to the employers, or to the taxpayers), or objective (e.g., percentage of staff workload required for key activities with respect to total workload, or percentage of related costs with respect to total costs).

The resulting quality index could be compared to 1) a single-figure standard for the minimum acceptable level of quality, below which the SESA could be funded at a single reduced rate, 2) a single-figure standard for average level of quality, above which the SESA would be funded at a single higher rate, or 3) a schedule of quality levels corresponding to different levels of funding.

These three alternatives could themselves encompass a wide range of adjustment alternatives. For example, the minimum and maximum could be set at levels that would punish or reward, respectively, only one or two extreme cases each year or even an occasional case every few years, similar to the results of the prevailing method of electric utility rate regulation. Alternatively, these benchmarks could be set so that, for a large percentage of States, say 30 percent, funding grows at rates lower or higher, respectively, than the average State. In regard to the schedule, it could comprise a broad middle tier and two unbounded edge bands, resulting in altered rates for only the outliers, or it could comprise several tiers corresponding to rates that differed only slightly.

Suggestions for Future Research

There are specific opportunities for further research related to claims processing in the private insurance industry. Two insurance industry associations suggested that their members might cooperate in a blind study of their claims processing costs and quality. While identifying the relationship between these variables in the insurance industry would not be particularly useful, assuming a similar study of UI itself could be done, a survey of the budgeting techniques used by these competitive firms might reveal some useful information not obtained in the current review. The suggestions noted in Section IV could prove fruitful in helping to validate or invalidate the conclusions reached in those studies.

Finally, it should be recognized that we have not exhausted all possible sources of information relating to any aspect of literature search. Given the limited time budgeted for this investigation we had to draw the line somewhere in each direction. In regard to other Federal/State benefit programs, aside from library searches, we relied heavily on the results of a survey performed by DOL and contractor staff in relation to funding methodologies. Although we made some telephone inquiries directly to some of the administering agencies, time did not allow for a complete agency-by-agency search for relevant information, even through SME interviews. More could be done in this regard.

An example of a particular line of Federal agency inquiry that remains open involves the Disabilities Insurance program (DI) of the Social Security Administration (SSA), which is responsible for funding the States' Disability Determination Services (DDS). DDSs determine whether claimants are disabled according to program rules. In 1987, the DDSs convened the workgroup that led to the development of the Cost Effectiveness Measurement System (CEMS), which tracks costs and quality factors by State. The purpose of the system was to develop average cost per case (CPC) factors that would be used to set future funding levels.[126] The data collected during the development period for the CPC might allow for the across-State comparison of the variance of quality with that of cost for that type of program.

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[126] Deloitte, Haskins, and Sells; Cost Effectiveness Measurement System; Informational Booklet; Social Security Administration/Office of Disability.

On the regulated industries front, it can be readily seen that we have identified some States and even specific utility companies that have proposed or implemented innovative regulatory schemes that we did not have a chance to investigate thoroughly through interviews with SMEs from the particular State or company. Tying up these loose ends could be done relatively quickly by future researchers, should it be determined that the gulf between the nature of the regulated industries and UI is not so large as to preclude useful comparisons.

There is a "second phase" of research that would be required if this initial investigation leads to the development of some procedure for incorporating quality into the UI funding process. Before the particular method of performance-based funding would be proposed, whether a completely new methodology or an adjustment to one of the existing or proposed funding systems, there must be extensive research into the effects of implementing the change. This would have to cover all the bases, similar to the exhaustive evaluation still being undertaken by the AFI workgroup. The effect on the budgeting process will have to be examined, historical comparisons of the grant to each State under the current system and the performance-based system would have to be made, as would forecasts of future grants under each system.

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APPENDIX A

PERFORMANCE-BASED FUNDING OF ADMINISTRATIVE ACTIVITIES IN STATE UNEMPLOYMENT INSURANCE PROGRAMS

SUBJECT MATTER EXPERTS INTERVIEWED

Ackerman, Eric
Senior Manager of Regulatory Policy
Edison Electric Institute
701 Pennsylvania Avenue, N.W., 5th Floor
Washington, D.C.
202 508 5528

Adams, William D.
Supervisor--Gas and Water Rates Section
Utilities Division
Iowa Utilities Board
Iowa Department of Commerce
Des Moines, Iowa 50319
515 281 5979

Bauer, Karen
Editor
Utility Regulatory Policy in the U.S.
National Association of Regulatory Utility Commissioners
Interstate Commerce Commisssion Building, Constitution Avenue
Washington, D.C.
202 898 2215

Bivens, Danny
Fuel Analyst
Texas Public Utilities Commission
7800 Shoal Creek Boulevard
Austin, TX
512 458 0100

Burns, Bob
Senior Research Specialist
National Regulatory Research Institute
University of Ohio
1080 Carmack Road
Columbus, OH 43210
614 292 9307

Casson, Hal
Office of Quality Appraisal
Division of Program and Cost Management
DOL/ETA/UIS
Washington, D.C.
202 219 5626

Costas, Marvin
Resident Scholar
American Enterprise Institute
Washington, D.C.
202 862 5800

Dokter, Judi
Employee Benefit Consultant
Self-Insurance Institute of America
Irvine, CA
714 261 2553

Fyffe, Kathleen
Director--Payment Systems
Health Insurance Association of America
1025 Connecticut Avenue, N.W.
Washington, D.C. 20036
202 223 7780

Gallina, Victor
Supervisor-Telecommunications Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus, OH 43215
614 644 7861

Gordon, Martin
Senior Program Manager
Energy Research & Development
National Rural Electric Cooperative Association
Washington, D.C.
202 775 8300

Harris, Frank S., II
Senior Associate
L.E. Peabody & Associates, Inc.
Economic Consultants
Alexandria, VA
703 836 0100

Johnson, Caroline
General Counsel
National Association of Insurance Commissioners
Kansas City, MO
816 842 3600

King, Charles W.
President
Snavely, King Associates, Inc.
Economic Consultants
Washington, D.C.
202 371 1111

Laham, Jim
Former Project Officer (Currently UI Program Specialist)
Performance Measurement Review
Division of Program and Cost Management
DOL/ETA/UIS
Washington, D.C.
202 219 5616

Lawton, Raymond
Associate Director
National Regulatory Research Institute
University of Ohio
1080 Carmack Road
Columbus, OH 43210
614 292 9014

Lennan, Anne
Director of Federal Affairs
Society of Professional Benefit Administrators
2 Wisconsin Circle
Chevy Chase, MD 20815
301 718 7722

Leonard, Norman
Utilities Technical Analyst
Maine Public Utility Commission
242 State Street
Station 18
Augusta, ME 04333
207 3831

Linder, Ken
Director of Rates and Regulation
Edison Electric Institute
701 Pennsylvania Avenue, N.W., 5th Floor
Washington, D.C.
202 508 5000

Markham, Jim
General Counsel and Vice President-Personnel
American Institute of Chartered Property and Casualty Underwriters
720 Providence Road
Malvern, PA 19355
215 644 2100

McDonald, Don
Communications Engineering Supervisor
Florida Public Utility Commission
Talahasse, FL
904 488 1280

Rabung, Bill
Chief--Division of Correction Strategies and Techniques
Office of Quality Control
DOL/ETA/UIS
Washington, D.C.
202 219 5604

Schroeder, Bill
Vice President--Claims
Alliance of American Insurers
1501 Woodfield Road, Suite 400 West
Schaumberg, IL 60173
708 330 8500

Sidak, Greg
Resident Scholar
American Enterprise Institute
Washington, D.C.
202 862 5892

Simmons, Rod
Technical and Special Assistant
Performance Measurement Review
Division of Program and Cost Management
DOL/ETA/UIS
Washington, D.C.
503 378 3089 (in Oregon)

Taylor, Alan
Chief--Bureau of Service Evaluation
Florida Public Utilities Commission
101 East Gaines Street
Tallahasse, FL 32399-0866
904 488 1280

Taylor, Cheryl
Librarian
Electric Power Research Institute
Washington, D.C.
202 872 9222

Wandner, Steve
DOL/ETA/UIS
Washington, D.C.
202 219 4620

Administrative Funding of Unemployment Insurance as a Principal-Agent Problem

by

Carl Davidson and Lawrence Martin
Michigan State University

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1. Introduction

The money used to finance unemployment insurance (UI) in the United States comes from two sources. Individual states must raise the revenue required to finance benefit payments, but they bear no responsibility for the financing of the administration of the system. Administrative expenses are funded by the Federal Government with money appropriated by Congress out of accumulated Federal Unemployment Tax revenues. There is widespread (and justified) dissatisfaction with the procedure used for allocating funds available for administration among states. It is argued that the current system not only fails to promote efficiency but may also encourage waste. The purpose of this paper is to analyze the incentive problems inherent in the problem of administrative funding, evaluate the current system and some alternatives, and propose reforms.

From the standpoint of economic theory, this is an example of the "principal-agent problem." The Federal Government, which is the principal, effectually contracts the various State Governments as its agents to administer the UI system. The Federal Government provides the required funds and expects the States to perform in an efficient manner. This arrangement has certain advantages -- the State Governments are closer to the customers, more informed about individual preferences and needs, and potentially subject to more careful taxpayer scrutiny. The fundamental difficulty is that State Governments inevitably have some leeway to pursue their own interests, which may conflict with those of the Federal government. For example, States may not be diligent about timely payment of interstate claims or they may not be sufficiently careful to avoid authorizing payment to ineligible claimants.

The literature concerning the many variations of the principal agent problem is vast and the basic approach to the problem is by now well accepted.[1] In this setting, the principal's goal is to design a scheme (a mechanism) in such a way as to motivate the agent to use its information and effort in a manner that promotes the principal's agenda. A successful mechanism is said to implement the desires of the principal.

This modern approach to policy design differs from the older, more traditional approach which, if applied to the issue of funding the administration of the UI system, would consider questions related to the magnitude of an already chosen regulatory mechanism. For example, under the older approach there might be concern as to the number of samples needed to be relatively certain that out of state claims are being paid promptly, or, alternatively, there might be an attempt to determine the level of funding required to finance administration of a given quality. In contrast, the modern approach emphasizes the design of the mechanism itself. Therefore, it requires us to ask more basic questions, such as, should payments be based on performance? and/or, should states be required to refund any unused appropriations? Of course, once these more basic questions have been answered, those issues addressed by the

[1] See, for example, Milgrom and Roberts (1992) or Laffont and Tirole (1993).

older approach must also be tackled -- If quality is to be rewarded, which measures of quality should be used? How (explicitly) should funding be tied to these measures?

There are several issues that must be addressed in order to design an effective mechanism. First, we must begin by specifying the goals of the principal and the interests of the agent. In particular, we need to be clear as to the circumstances under which their interests differ. Second, we must determine exactly what information each party has available at each stage of the process. Can the Federal Government observe the various dimensions of quality? Can it determine actual administrative costs? Can it distinguish between justified expenditure and wasteful spending? The third step in solving the problem requires us to determine which strategies are feasible for the principal to use. Can the Federal Government administer fines for poor performance by individual States? Can it credibly threaten to revoke the FUTA tax credit offset? And, finally, there is the issue of timing. For example, is there sufficient time to negotiate differences before funding levels are adjusted?

In the next two sections, we provide an overview of the relevant aspects of the UI system. The purpose of this is neither to give a complete historical account of the system nor a detailed exposition of its rules and regulation. Rather, our purpose is to provide answers to the questions raised in the preceding paragraph -- that is, we want to set up the principal-agent problem with respect to the administration of the UI system. We then turn our attention to mechanism design for the funding of UI administrative expenses in section 4. Throughout that section we restrict attention to the relationship between the Federal and State agencies. In section 5, however, we bring in the taxpayer as a competing principal and investigate whether taxpayer oversight of state performance can be harnessed to promote efficient administration without compromising quality. The current method for financing UI administration and some recently suggested alternatives are discussed in section 6. In section 7 we turn our attention to this issue of how the Federal Government should go about determining the overall level of funding necessary to achieve its objectives. We argue that since the mechanism that we describe in Section 4 includes the "right incentives" (in terms of efficiency), this a fairly straightforward issue. Finally, we provide some concluding thoughts in section 8.

2. An Overview of the UI System

A. Establishment and Rationale for Federal Oversight

The United States Unemployment Insurance system was established through federal legislation in 1935 after the failure of several private plans.[2] At the time of its establishment only one state (Wisconsin) had an ongoing system of unemployment compensation and neither private nor state level unemployment insurance systems

[2] See Haber and Murray (1966) pp. 61-63.

were spreading. It is important to understand why this was so and what this implies about the differing goals of state and federal administrators.

There are both incentive and efficiency concerns that argue for federal involvement in the UI system. The incentive problems arise because both adverse selection and moral hazard can undermine private and state level UI programs. The fact that UI has some attributes of a public good raises the efficiency concerns. Each of these issues explain, in part, why unemployment insurance arose only in response to Federal government initiative. Moreover, they also imply that, in general, states will prefer a more economical system and may even prefer a lower quality of benefit delivery.

Consider first the problems created by adverse selection. Insurance is provided successfully by pooling people of similar risks, forecasting the cost of providing insurance, and charging premiums based on those forecasts. If the insurer lacks the necessary information (or if it is constrained by institutional restrictions), it cannot discriminate among its clients and it must charge the same premiums to all demanders of its service. If it bases its premiums on population averages, the insurer will likely find that those who choose to buy insurance are more costly (i.e., face greater risk) than the population. The reason is simple -- insurance is more appealing to those who face greater risk of loss and these relatively risky individuals will be more likely to choose to insure themselves. The insurer will soon find that its costs exceed its forecast. However, raising the premium to cover costs will not help. Such an increase makes insurance less appealing to the lower risk customers, causing them to drop their coverage. This, of course, causes costs to rise even further.

To see the relevance for UI, consider a state that offers more generous unemployment compensation than its neighboring states. In the absence of perfect experience rating, workers and firms that are more likely to make use of the UI system would find that state relatively more attractive. The cross subsidy that is implicit in the system would favor higher cost workers, firms and industries at the expense of their less costly counterparts. Therefore, such a state could anticipate attracting more of these higher cost workers and firms.[3] Furthermore, the more generous system would encourage the expansion of relatively high cost (in terms of UI) industries. The net effect of these forces would be to increase claims and benefit payouts, thereby necessitating higher taxes.

These same considerations imply that any state offering a higher quality system would experience higher costs. Faster benefit payments, more timely appeals and fewer errors make the system relatively more attractive, and this attraction is most important for those workers, firms and industries more likely to use the system. Again, unless experience rating is perfect, the same incentives outlined in the previous paragraph will exist -- a higher quality system may also be a more costly one.

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[3] There is considerable evidence that interstate tax differentials affect industry location. See, for example, Bartik (1985, 1991) or Papke (1993).

Similar difficulties are caused by moral hazard. Since insurance provides compensation in the event of a loss, insured individuals face a reduced incentive to protect themselves from suffering a loss. The result is more claims and higher costs for the insurer. There is, by now, substantial evidence that higher benefit levels result in longer spells of unemployment[4] and consequently, greater costs for the UI system. As with adverse selection, a higher quality system can be troubled by the same increased costs that are generated by a higher replacement rate. Timely payment of checks by courteous clerks makes the system more pleasant and provides an additional incentive to remain unemployed. Moreover, by enhancing the efficiency of the system a state reduces the cost of filing for benefits and may attract workers who would otherwise not bother to claim their benefits (this is not a trivial concern -- Blank and Card (1991) estimate that over 25% of UI-eligible unemployed workers never bother to claim their benefits). Therefore, once again, there are forces present that imply that states may be reluctant to enhance the quality of their UI system.

Finally, even if we ignore these incentive issues, there is an additional reason for Federal oversight and regulation of the UI system. Unemployment insurance acts as an automatic stabilizer by increasing consumption during downturns in the national economy. For example, Hamermesh (1977) finds that for roughly half of the UI recipients benefit payments loosen liquidity constraints and enable them to maintain consumption during recessions to a greater extent than would be possible through dissaving or borrowing. More recently, Gruber (1994) has provided even stronger evidence by showing that consumption of UI recipients falls by roughly 7% during unemployment while he estimates that it would have fallen by roughly 22% in the absence of UI. This additional consumption adds to aggregate demand and may lessen the length and severity of economic downturns.

Presumably, when states consider increasing unemployment benefits they focus on the impact on their own residents and ignore any spill-over effects affecting non-residents. Since non-residents gain from macroeconomic stability and since their gain is ignored by individual states when devising their UI systems, individual states are likely to underprovide benefits. And, as we have emphasized above, this also translates into diminished incentives for the states to administer high quality systems.

In summary, there are a variety of reasons to expect that states would prefer to offer a system of lower quality than the Federal government would desire -- the interests of the states and the Federal governments are likely to diverge.

B. State Program Quality

The Social Security Act also set minimum program requirements for state UI systems and established review procedures to ensure that state programs remain in compliance as changes occur over time. Nevertheless, states have often proposed

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[4] See, for example, Hamermesh (1977) or Katz and Meyer (1990).

weakening their system.[5] For example, laws requiring unemployed workers to accept wage offers significantly below their previous earnings[6], laws reducing interstate claimant eligibility or benefits[7], laws mandating additional waiting weeks or subjecting workers to means tests have all been proposed or passed by various state legislatures.

In the previous section, we argued that the forces that lead states to desire less generous programs also lead them to desire less efficient systems. Thus, we would expect states to try and economize on quality by delaying checks, handling appeals slowly, and so on. Perhaps with an eye toward these forces, the Federal government monitors state operations and encourages improved program performance through a variety of programs. The Cost Management System measures the actual time required to produce several types of administrative output. The Quality Control Program focuses on identifying errors in benefit payments and revenue collection. The Benefit Payment Control Programs investigate cases of possible fraud and attempts to recapture money erroneously dispersed.[8] In addition, the Quality Appraisal System measures each state's performance in over twenty categories of timeliness and accuracy and compares them with the Federal standards. Finally, there are the Cash Management Initiative and the Data Validation Program, which promote better cash management and data collection, respectively. At present, however, there is no connection between any Federal measurement of quality and the level of administrative funding received by the states.[9]

C. Administrative Funding and Costs

According to Title III of the Social Security Act, the Federal government is required to provide grants to the states so that they may administer their UI programs:

> To encourage efficient administration, without which unemployment insurance will fail to accomplish its purpose, we believe that the Federal Government should aid the States by granting them sufficient money for proper administration, under conditions designed to insure competence and probity. (Committee on Economic Security, 1935, p.19, 4).

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[5] Of course, some States with a strong labor influence have provided UI systems that are more liberal than required. For example, some have expanded coverage of the program beyond what is required by the Federal Government.

[6] Connecticut in 1973 -- see Rubin (1983) pp. 57.

[7] See Rubin (1983), pp. 71.

[8] Although in this case, it is hard to argue that the Federal Government cares more about this type of mismanagement than the States.

[9] See Fu Associates (1994).

It is important to note that the Federal Government is charged with the duty of encouraging efficient administration. The Act also makes it the Secretary of Labor's responsibility to make sure that states receive funds sufficient to provide for the "proper and efficient administration" of the UI system.[10] However, there are certain provisions that State laws must meet before the Secretary can certify payment of a State's administrative costs. These include, for example, the opportunity for a fair hearing for all individuals who have been denied UI.

Administrative funds have been allocated in a variety of different ways since the inception of the UI system. At one time states were required to submit detailed budgets or provide estimates of the time and effort required to carry out each task. Since the 1970s, however, the allocation of administrative funds has been largely based on data collected through the Cost Model Management System. Briefly, Cost Model Studies were used to determine the amount of time it took to perform each task in each state. These measures were then combined with workload estimates and estimates of each State's insured unemployment rate to obtain allocations for each state. Due to budget considerations[11], the government stopped the Cost Model Studies in 1984, but has continued to allocate administrative funds based on the measures it has already collected. It is important to note that such a system does not encourage efficiency; in fact, it encourages inefficiency -- the longer it takes to perform tasks, the more money the State receives. We will discuss the merits and deficiencies of this approach in section 6 below.

D. Cross Subsidization

As we pointed out in the last section, the Federal grant for administrative funds is based, in part, on the insured unemployment rate. This varies across states over the business cycle since recessions do not affect all states in the same manner. States with low unemployment rates generate more revenue than their counterparts while states with high unemployment rates require larger grants for their larger programs. Over the long run this difference may even out, but in any individual downturn there is considerable cross subsidization.

There are sound economic reasons for cross subsidization. Unemployment increases during recessions and with unemployment insurance in place aggregate demand falls less than it would in its absence. As a result, recessions do not last as long and are not as severe as they would be otherwise. This provides an additional rationale for Federal involvement in the UI system. Unlike the Federal government, States governments must balance their budgets. Recessions reduce state revenues

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[10] Section 302 of the Social Security Act [42 U.S.C. 502].

[11] These budget considerations probably arose because the States figured out how to manipulate the system. They realized that by taking more time to administer the system, they could obtain more funding from the Federal Government. Thus, expenditure on UI continued to increase.

and increase the demand for state programs. Thus, during a recession there is an incentive to divert resources away from the administration of the UI system toward other programs. This is unfortunate, since this is exactly when the need for unemployment insurance funds is the greatest. By allowing the Federal government to allocate funds across the States, it is possible to maintain a consistent level of administration.

3. Administrative Funding as a Principal Agent Problem

Based on the overview provided in section 2, we are now in position to set-up the mechanism design problem faced by the Federal government. We do so in this section. We provide our solution to the problem in section 4.

A. The Players and their Objectives

The Federal government occupies the role of the principal. It seeks to use appropriated funds in a manner that promotes the highest quality UI system. Since it has limited funds, it also wants to make sure that the states minimize the costs associated with administering their programs -- after all, any cost savings can be used to raise quality even further. Finally, since recessions hit some states harder than others, the Federal government may want to achieve some level of cross-subsidization by allocating more funds to high-unemployment states (where the administrative need is greatest).

The states governments act as the agents in this setting. Their goal is to gain control of resources -- that is, to make their appropriated funds available for their own projects. In addition, while they may be under some pressure from the taxpayers and the Federal government to maintain some level of minimum quality, the states face competitive pressure not to make the system too attractive. In other words, there is some incentive to scrimp on quality, or, at least, to provide a lower level of quality than the Federal government would desire.

The third player in the game is the taxpayer. There may be some conflict of interest between the state unemployment agency and the taxpayers. We will ignore this issue in this and the next section. We will return to this issue in section 5.

B. Information

There are several pieces of information that the Federal authorities either need or would like to have in order to allocate administrative funds. As we discussed in section 2.A, insurance markets operate more efficiently when the insurer can observe the effort and the individual characteristics of those it wishes to insure. If these features can be observed, moral hazard and adverse selection problems need not arise. Thus, the Federal government would like to be able to observe the level of effort expended by state agencies as well as some key characteristics that vary across states. Some of this information is easily observable while other information may be virtually impossible to collect. Of course, the administrative funding mechanism

cannot be based on information that is unavailable to the Federal government. Rather, it must depend only on observable factors.

Consider first the issue of effort. There are several factors that are directly controlled by the states that affect costs or quality that may not be observable by the Federal government. For example, the Federal government cannot hope to accurately measure the number of hours worked by state managers or the intensity of their effort. Other decisions, such as purchasing inputs at high prices, assigning unjustified perquisites, delaying unpleasant personnel moves or tolerating excess inventories may be impossible for the Federal government to evaluate -- they are simply too far from the situation to be able to distinguish cost efficient decisions from those that are simply wasteful[12]. In each case, extra effort at the state level could improve the performance of the UI system. But, in each case, that effort is unobservable.

Turn next to the key characteristics that vary across states. To begin with, the Federal government has limited information about the states' production technologies. Although there has been considerable study of the production methods across states,[13] it is probably unrealistic to think that the Federal government can distinguish between states that are inherently less productive and those that are more productive but are putting forth minimal effort.

There are two dimensions to this problem. First, technologies may differ across states because of population differences. There is a widespread belief that more densely populated sates can operate at lower average costs simply because they have more claims in a given geographic area. Similarly, larger states may be able to take advantage of economies to scale by spreading fixed costs over a larger number of claimants. While these two factors, population size and density, are exogenous as far as the UI system is concerned, both are observable. It follows that the differences in technologies that are caused by these factors can be investigated empirically and some estimates can be obtained of the effects of each on the cost of administration.

The second dimension concerns differences in technologies caused by past decisions, and this is where the problem lies. Progressive state agencies that adopted cost savings measures in the past (e.g., training, updated software, office design) will possess better technologies than those state agencies that slid by with minimal thought to improvement. Detecting differences across states in this dimension is much more difficult, although it is still possible to make some distinctions (e.g., the extent of computerization).

Other key characteristics are somewhat easier to observe. Each state's insured unemployment rate can be forecasted reasonably well and it is measured accurately after the fact. In addition, there are the various aspects of quality. While not directly

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[12] We usually do not think of these decisions as being tied to "effort." However, we should -- after all, if managers put forth the correct amount of effort to run the system efficiently, these decisions will be made correctly.

[13] See Vroman (1993).

observable, the quality of each UI system can be measured with sampling. In fact, as we noted above, the Quality Appraisal System currently measures the performance of State UI systems in over twenty dimensions of quality including timeliness and accuracy of payments. Thus, administrative funding could be tied to these measures.

In summary, it would be difficult, if not impossible, to allocate administrative funds on the basis of what we refer to as effort. But, some information concerning current differences in technology, business cycle conditions and the quality of service can be used in the allocation procedure.

C. Strategies and Timing

The final elements of the model that we need to specify are the actions and strategies that are available to the principal and the agents. Control over administrative funding gives the Federal government a powerful instrument that it can use to influence state performance. Although the lack of reliable information precludes basing allocations on measures of state effort, the funding level can be tied to population density, the insured unemployment rate and/or various measures of quality. With respect to quality, payments could depend on the measure of each state's quality or how that measure compared to the national average. In addition, parallel to the current distinction between base and contingent funding, one allocation could be made on the basis of predicted insured unemployment and another additional payment could be delivered after the number of actual claims have been observed.

The Federal government also has the authority to withdraw funds entirely if it determines that a state's administrative performance is not up to some minimum standard. In fact, this is the incentive mechanism currently used to foster state programs in the offset credit against FUTA taxes. In the principal agent literature this is known as the "boil in oil" approach -- requirements are set and any failure to meet them results in severe punishment. Such an approach is appropriate when there is no uncertainty in the process or when there is time to correct any shortcomings before the punishment is delivered. After all, if there is uncertainty and a requirement is not met, the principal cannot be certain as to the reason for failure. It could be due to a lack of effort by the agent, mismeasurement by the principal, or just bad luck. If the principal has ample time to verify its estimates or observe the resolved uncertainty, then this might not be a problem. However, if this is not the case, then, if the principal uses the boil in oil approach, it could end up meting out severe punishment to an agent who has put forth every effort to meet the principal's requirements.

As far as the UI system is concerned, it is clear that the Federal Government has ample time to correct any measurement errors and observe uncertain factors such as the insured unemployment rate before meting out such severe punishment. Nevertheless, previous experience indicates that any such threats are not likely to be perceived as credible by the states -- in practice states are not "boiled in oil." The penalty for non-conformity with the FUTA provisions has been assessed only once, and administrative grants have only been withheld twice (see Rubin 1983 p.139).

Instead, mutual negotiation between the Department of Labor and the state over proposed legislation is the rule.[14]

Two more radical strategies that are feasible involve either federalizing the administration of the UI system or getting out of the administrative area altogether by transferring the task (and presumably the taxing authority) to the states. Although these two strategies could be thought of as allocation mechanisms, we will not consider them in the next section. We will discuss them in section 6.

4. An Efficient Mechanism

At this point it is useful to step back and summarize the argument that we have presented in the preceding sections. The institution of unemployment insurance required the involvement of the Federal government, largely due to the fact that this type of insurance is troubled by problems of adverse selection and moral hazard. States are reluctant to offer more generous programs or improve the quality of their existing program since both steps would result in higher costs. Furthermore, the States' desired levels of benefits and system quality are less than the levels desired by the Federal government because states ignore the stabilization benefit that the UI system provides for the national economy.

The Federal government's goal is to use the allocation of administrative funding for three purposes: to encourage high quality administration at low cost, to encourage quality-enhancing and cost-reducing innovation, and, at least to some extent, to compensate states for especially high costs that are due to factors beyond their control (e.g., population size or density, especially high unemployment, and/or poor technology decisions that were made in the past). Funds may be allocated on the basis of observable measures of quality, but not on the basis of effort since it is impossible for the Federal government to accurately observe, measure or estimate the level of effort expended by state agencies.

There are three factors that put the Federal Government in a very strong position. First, it controls the money -- funds for administration are appropriated by Congress and then disbursed to the States by the Secretary of Labor. Second, the Federal Government is able to collect a great deal of information about the States and their UI systems. Although it cannot observe State effort or the true cost of running an efficient system, it can garner a reasonably good set of quality measures, and it can measure several long and short run variables that affect technological differences across states (e.g, population size and density, business cycle conditions, etc.). Finally, the Federal Government does not need to be overly concerned about the

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[14] States usually include a "savings clause" in UI legislation that states that the bill's provision will become effective only if approved by the Department of Labor. However, in some cases in which non-conforming legislation has been passed, the Department of Labor has either chosen not pursue the issue or it has actually changed its interpretation to federal law.

quality of its initial estimates -- there is ample time to adjust payments to States if, for example, there are disputes over the quality measurements or if there are unexpected shocks to State economies.

In this section we outline a funding mechanism that takes advantage of these factors and encourages efficient administration of UI. Specifically, the mechanism we propose motivates low cost provision of administrative services, high quality and continual improvement in the system over time. Moreover, our mechanism allows the Federal Government to achieve the level of cross subsidization that it desires. We address each of the issues and the corresponding features of the administrative funding mechanism in turn.

A. Low Cost Administration

The Federal Government seeks to motivate efficient, low cost delivery of unemployment. There is an obvious advantage to allowing the States to make the on-site decisions concerning personnel, equipment, and procedures since State administrators have better knowledge of local conditions. Moreover, since each State has somewhat different rules and regulations, the decentralized approach allows State administrators to acquire and exploit specialized knowledge.

Opposing these advantages is the fact that State effort cannot be observed directly by the Federal Government. Any transparent attempt to measure effort will be subject to manipulation by the States if they perceive that the outcome will be linked to future payments. For example, the Cost Model Management System measured the amount of actual time used to complete certain administrative procedures. The longer it took to complete these tasks, the more money the State received. The clear incentive is for States to slow down the performance of each task in order to increase their allocation of funds. Whether or not the manipulation of the system is duplicitous or even conscious does not matter, the incentive remains.

There is a well known contract that overcomes this problem. It is known as the "residual contract." Specifically, if agents can keep any residual cost savings resulting from his or her (unobservable) effort, then the agent has the strongest incentive to keep costs low. In the principal-agent literature economists often refer to the power of an incentive mechanism. The residual contract is a very powerful way to motivate effort.

In order to implement a residual contract, the funding mechanism must satisfy two conditions. First, the allocation of funds must not depend on costs, either contemporaneously or with a lag. If it does, then every time a State considers instituting some cost savings measure it will need to take into account how the move affects its funding. If it does not, then no strategic considerations as to how the level of funding may be affected will muddy the State's analysis. Second, the States must be allowed to keep any unspent residual. This can be accomplished either by allowing States that do not spend their full allocation to keep the residual, or by allocating somewhat less than the likely administrative expense, requiring the States to finance the difference out of general revenues.

Ideally, any procedural reform, personnel decision or equipment choice should be analyzed on the basis of costs and benefits. If a State can reduce costs through some reform, then under a residual contract it is rewarded dollar for dollar. Furthermore, the incentive carries over to the area of legislative reform. Some critics of the system have pointed out that individual States have different technologies because legislative mandates, regulations and procedures vary across States. With a residual contract, legislators should realize that any change in legislation affecting UI will carry with it revenues equal to the full amount of the cost savings. This is obviously a powerful incentive.

In summary, one feature of an optimal mechanism should leave the States with the residual cost savings of any action that it takes. This feature provides a powerful incentive to keep costs low.

B. High Quality

We have argued that States must be given strong incentives to achieve and maintain high quality administration. If left to pursue their own interests, States will tend to choose a less than satisfactory level of quality. This is true even if administrative expenses are funded through Federal Government allocation, since the States' private benefit from a high quality system falls short of the Federal Government's evaluation of the benefits. This divergence between Federal and State preferences stands as an obstacle that the mechanism must overcome.

On the other hand, working in favor of success is the fact that quality is observable -- or, to be more precise, measures of quality can be obtained by sampling. Indeed, the observability of quality allows the use of another powerful incentive device: pay for performance. If the Federal Government allocates administrative funds by paying States according to the results of quality appraisals, then this procedure, combined with the residual contract discussed above, provides all the motivation necessary to ensure that States will strive to provide high quality administration.

In order to implement a pay for performance mechanism, the principal must know three things. First, it must determine what measures of performance it cares about and their relative importance. For our purposes, this is equivalent to asking: What measures of quality should the Federal Government use? In the Appendix, we reproduce Table 1 from a recent paper by Fu Associates on administrative funding.[15] This Table lists some of the quality measures provided by the Quality Appraisal System. These measures provide as good a starting point as any others. Beyond this list there are additional factors such as benefit accuracy and the degree of experience rating. The exact set of measures on which to base allocations is really a job for experts in the field and is beyond the scope of this paper.

The second piece of information that the principal needs is the technology. In our setting, this is equivalent to asking how effective financial incentives will be in promoting quality service. Since this type of funding mechanism has never been tried

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[15] See Fu Associates (1994).

in this area, one cannot confidently predict how readily State UI administration will respond to the prospect of financial rewards. Over time, as the Department of Labor gained experience observing State innovations, it would learn something about this relationship.

Finally, the principal needs to know its budget constraint. This, of course, is given by the annual Congressional appropriation.

With these three pieces of knowledge, the Federal Government has a well defined optimization problem, the solution to which carries with it the shadow prices for each of the quality measures. Each of these magnitudes is the marginal willingness to pay for an increase in the corresponding quality measure. In addition, if the Federal Government's estimates of State responsiveness to the incentives are correct, payments will exactly equal the appropriation.

While the shadow price is the ideal amount to pay for quality, estimates will only be approximations, at least for some time. It is not, however, terribly important to determine these values precisely. If the Federal Government chooses the wrong values, then the resulting disbursement may not exactly balance the budget. For example, if the Federal Government predicts higher measures of quality than ultimately result, States will collect less than the available funds. Federal projections that are too pessimistic will result in a deficit.

To guarantee a balanced budget, the following two-step procedure can be used. First, offer estimates of the shadow prices at the beginning of the year and allocate a portion of the budget on the basis of the estimates. Second, after the quality measures have been compiled, adjust the shadow prices and allocate the remainder of the fixed budget.[16] This procedure eliminates the uncertainty over balancing the budget and it eliminates the need to estimate the States' responsiveness to pay for performance. On the other hand, it does subject the States to some uncertainty regarding the actual price per unit of quality. A balanced budget requirement imposes some fundamental uncertainty on any pay for performance mechanism, because the achieved quality levels cannot be known beforehand. In effect, fixing the shadow prices ex ante results in uncertainty at the Federal level, while adjusting them ex post results in uncertainty at the State level.

C. Continuous Improvement

It is clear that we want our funding mechanism to motivate States to continually improve their administration of UI. New management techniques, personnel appointments, reorganization, and the adoption of cost saving technologies should be encouraged. States should also be motivated to seek ways to improve quality, reduce errors, pay benefits promptly, and adjudicate appeals quickly. One of the great advantages of decentralized administration is that it allows agents on the spot to use their local, specialized knowledge to innovate, resulting in lower costs and higher quality service. But the principal must provide them with incentives to do so.

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[16] This idea parallels the current distinction between base and contingency funding.

The combination of a residual contact and pay for performance provides these incentives. If a State chooses not to adopt some cost reducing innovation, it forgoes revenue. By the same token, any State that chooses to overlook some quality enhancing opportunity will receive a lower allocation of administrative funds than it would have received had it pursued the opportunity. Thus, the incentives that motivate efficiency in the short run also encourage continual improvement of the system.

Finally, it should be emphasized that the policy of pay for performance must be credible. The Federal Government must commit to this policy for a substantial period of time. This is vital, since the most efficient method of administration may involve a large current investment (e.g., computerization) that brings about cost savings in the future. No State will proceed with an expensive overhaul unless it is convinced that the promised funds will arrive when the enhanced performance is realized.

D. Cross Subsidization

If all States were identical in their ability to administer UI efficiently and if they all met the same experience with each recession, then the issue of cross subsidization would not arise. Since each State would always face the same prospects, there would be no justifiable reason for extracting more revenue from one State to finance additional expenses in another. But, States are not identical and there are both equity and efficiency arguments that might lead the Federal Government to choose to cross subsidize. We have already discussed a variety of factors that might be used to determine rate of cross subsidization. These include long run factors such as population size and density and the current state of technology in each State (although the latter is somewhat controversial). It also makes sense to allocate more administrative funds to States that have higher insured unemployment rates, especially during recessions.

There are two characteristics of the UI administrative funding problem that make cross-subsidization a simple matter. First, most of the relevant factors on which to base allocations are observable. The Federal Government can estimate the impact of population size and density on administrative costs and allocate some portion of the appropriations to equalize the differences. Second, the allocations can be adjusted when unexpected events occur (e.g., a longer than expected recession). The current practice, for example, determines a base level of funding in part by predicting the insured unemployment rate in each State. Any deviation from the predicted value is then compensated through contingency funding. The fact that there is ample time to adjust allocations ex post makes any desired level of cross subsidization not only feasible but easy to implement.

There is only one problem that might arise -- States that spend more than the amount originally allocated might face liquidity constraints. However, given that the amount spent on UI administration is such a small fraction of overall State expenses, it is hard to imagine that this would be a significant problem.

E. The Mechanism

In summary, an optimal mechanism must possess three characteristics. First, States must be given an incentive to minimize the cost of providing whatever level of service they choose to provide. This can be accomplished by allowing them to keep any unspent funds. Alternatively, this could also be achieved by funding less than the requisite amount at the Federal level, requiring the States to raise the remaining funds through taxation. Second, in order to motivate high quality service, the Federal Government must audit quality and allocate funds according to the results. Finally, lump sum payments may be used to compensate States for higher costs due to either short or long run factors that are beyond their control. This cross subsidization could be achieved by allocating a base amount equal to some percentage of projected costs and a subsequent contingency amount which adjusts the allocation as new information about the States' unemployment rates are collected (this could be done on a quarterly basis). This simple mechanism provides the States with powerful incentives to minimize cost, maintain high quality service, and continually improve their performance. It also allows the Federal Government to provide States that have a relatively high costs structure with additional funds, if the additional costs are due to factors that the State cannot control.

In section 6 we discuss how this mechanism differs from the current method of allocating administrative funds. We also compare it to some other alternative methods. However, before turning to that topic, we extend our analysis by adding a new dimension to the problem -- we bring in the taxpayer as a competing principal. To do so requires us to specify how the interests of State Government officials differ from those of the State taxpayer. If their interests differ, we must then investigate the implications for the allocation of administrative funds.

5. The Taxpayers

Up to this point we have assumed that the interests of State UI administrators and State taxpayers coincide. This assumption is undoubtedly true in many cases, for there are certainly many conscientious bureaucrats in the UI system. It remains true, nonetheless, that any employment relationship in which the employee possesses superior information and expertise is ripe for exploitation. In this section we consider the possible conflict of interest that might arise between State administrators and taxpayers and the implications for the problem of allocating administrative funds.

The relationship between taxpayers and UI administrators constitutes yet another principal-agent problem. To administer the UI system, one must possess detailed knowledge of Federal law, State civil service regulations, State legislative history and a host of other relevant factors. Given the considerable experience required to obtain such knowledge and given the inherently technical nature of the activity, there is a good reason to hire a specialist to perform it. Thus, the taxpayers (the principal), who benefit from the system, employ State administrators (the agents)

to run the UI system. Yet, taxpayers have only limited ability and face inadequate incentives to monitor and evaluate the performance of their State's UI administrators.

This is only a problem if the interests of administrators differ from those of taxpayers. While it is possible that taxpayers and administrators may agree on many matters, it is also possible that State bureaucrats may desire to reduce their own effort, foster additional complexity of the system, enhance their own job security and/or act in a manner that promotes their own career without regard to the cost. Thus, administrators may incur higher costs than necessary in order to achieve the agreed upon level of quality. Furthermore, in some instances, State taxpayers, unable to distinguish between justifiable complexity and additional provisions that serve only to enhance the career of the bureaucrat, may exert an inefficient level of control. For example, they may place restrictions on the administrators that result in higher costs. In either case, the cost of running the system may be unnecessarily high.

If unspent administrative funds must be refunded to the Federal Government (the current case), then the taxpayers will not care that costs are too high -- that is, they will only be interested in the quality of service. This follows from the fact that the revenue returned to the Federal Government is unlikely to be spent on services that they consume (it could be spent on projects in the other forty-nine states). On the other hand, with a residual contract that allows the States to keep the unspent portion of their allocation, taxpayers will care about both quality and costs since any cost reduction will accrue to their own State treasury. Thus, the residual contract gives the taxpayer an incentive to monitor the behavior of administrators.

Unfortunately, this incentive may not be strong enough. After all, information is a public good -- if one taxpayer monitors or evaluates State administrators, the other taxpayers do not have to. Moreover, taxpayers in a given State have an incentive to free ride off of information collected in other States. The standard solution to this free rider problem calls on the Federal Government to collect and disseminate the information to all taxpayers.

The Federal Government can encourage taxpayer oversight of State UI systems by producing information. For example, they could publish summary statistics on relative State performance and expenditures (a ranking could even by published on an regular basis). Armed with convincing evidence of high administrative costs, taxpayers, lobbyists and others can campaign for cost saving reform.

This recommendation is similar to the traditional Federal Government role of assisting State administration by providing information concerning job training, improved procedures, or new technology. In this case, however, the Federal Government provides information, but the consumer of the information is the taxpayer, not State administrators. This is one indirect way to pressure States to lower costs.

6. Other Reforms

Other reforms of administrative financing have been proposed. One option is to completely federalize the UI system -- that is, run unemployment administration as

an agency of the United States Government in a manner similar to the Social Security system. Another option is to eliminate the Federal role in administrative financing and turn over the responsibility for raising the funds to the individual States. Alternatively, we could continue with the current method for allocating funds through the Cost Model Management System (in which the cost estimates have been frozen for the past decade). Finally, we could simply allocate fixed amounts to the States. In this section, we examine each of these proposals in the principal-agent framework and point out the problems inherent in each one.

A. Federalization

One drastic reform proposal assigns all the responsibility for administration to the Federal Government. This sidesteps the principal-agent conflict in a straightforward way -- it gets rid of the agent. On the other hand, it does nothing to solve the fundamental informational problems that are inherent in the problem of administration. In fact, such an enormous centralization of decision making can be expected to exacerbate these problems.

The usual arguments in favor of decentralization of decision making focus on issues related to information, motivation and innovation. As far as the administration of UI is concerned, States certainly possess better knowledge of their laws and regulations, their employees and their clients. The original design of the UI system allowed for (and, perhaps encouraged) different individual State systems, each with its own level of benefits, tax system, procedures and regulations. Federalization of administration without coordination of the rest of the system leaves the Federal Government with the responsibility of administering many different systems. The variation across States systems and the additional complexity this brings about mitigates the chief advantage of centralization -- coordination and standardization.

With respect to motivation, it is important to manage employees at the local level where their abilities and performance can be observed more easily. This makes it easier to match employees with the tasks that utilize their individual talents -- State administrators with years of experience are in a better position to assign tasks than their Federal Government counterparts. In addition, autonomy and local responsibility contribute to motivation. As we stressed in the previous section, State taxpayers have an incentive to encourage low-cost administration. Federalization would clearly weaken this incentive.

Finally, there is the issue of innovation. With fifty three individual systems there is wide latitude for experimentation. States can observe the performance of other systems and adopt successful procedures while avoiding failures. This process of experimentation, evaluation and dissemination of innovation can be enhanced through the kind of centralized information gathering and promulgation we emphasized in Section 5.

B. Devolving the Task to the States

The other extreme type of reform would devolve to the States all the responsibility for financing and carrying out the administration of the UI system. In

this case, the primary difficulty lies in motivating high quality administration. The ability to cross subsidize also disappears.

As we have emphasized above, States inherently prefer a lower quality of service than does the Federal Government. Leaving administration entirely to the States creates incentives for delayed payments, inaccuracies, slow handling of appeals, and many other symptoms of low-quality administration. To deal with this problem, devolution would have to be coupled with programs to monitor and evaluate administrative quality in the States. This would allow the Federal Government to observe any decline in quality, although with devolution, it would have no powerful tool that could be used to influence the States.[17] Rather than suffering financial consequences due to diminished quality, States could expect some administrative procedure (perhaps including threats of disqualification). The experience with Federal oversight of benefit and tax provisions of State UI laws provides little reason to be optimistic that the Federal Government could be effective in such a role.

Next, consider cross subsidization, an issue that is especially important during recessions in the unemployment rates vary across states. States that are hit the hardest during such recessions would be left on their own at a time when tax revenues reach their nadir. There can be no doubt that such States would find ways to reduce the quality of service offered in order to save on costs, which contradicts the whole point of UI. The benefits and high quality service should be there when they are needed the most -- when unemployment is high.

C. The Cost Model Management System

The Cost Model Management System was developed in the 1970s as part of an attempt to tie allocations of administrative funds to actual costs incurred in running State UI systems. In each State, auditors measured the amount of time required to perform each administrative task. These measures were then combined with workload estimates and estimates of insured unemployment to obtain an estimate of total costs. Funds were based on this final estimate with higher estimates leading to more funds. Finally, unused funds were "recaptured" by the Federal Government on a quarterly basis prior to 1986 and on an annual basis after 1986. The incentives built into this system are clear and counterproductive -- inefficiency and waste are rewarded while efficiency and effort are punished. Furthermore, since the time measures were updated periodically, States were encouraged to slow down. Finally, since States had to return any unused appropriations, there was no reason for them to try and lower costs. In summary, this method of allocating funds provides no incentives to innovate, lower costs, or provide a high quality of service.

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[17] Since taxpayers also care about the quality of service, it would be possible to leave it the taxpayers to exercise oversight. In such a case, the Federal Government would play a role by providing the information that the taxpayers need to pressure States to improve their performance.

Due to budget considerations (largely caused by the incentives discussed in the previous paragraph), the Federal Government stopped the Cost Model Studies in 1984, but has continued to allocate administrative funds based on the measures it has already collected. It is clear that this system should be abandoned.

D. Administrative Financing Initiative

Recently, the Department of Labor has proposed a reform of the administrative financing system that has been referred to as the administrative financing initiative (AFI). The AFI is similar to the method currently in use in that it bases funding on projected costs and uses estimates of State workloads to determine those costs. It differs in that it uses national measures of the time it takes to perform administrative tasks (what have been referred to as "National Unit Costs" or NCUs). Adjustments would be made for States that have high costs for reasons beyond their control (e.g., population size and density). This is an improvement over the current system in that it removes the incentive to slow down -- States with high costs due to inefficiency would no longer receive an increase in funds. Nonetheless, this reform has some flaws. Most importantly, there is no attempt to link performance to funding. Thus, there are no built in incentives to offer high quality service. Since it is unclear whether or not States would have to return unused appropriations, it is unclear whether or not there are incentives to lower costs and innovate.

7. How Much is Enough

There is one other issue that we must consider -- how can the Federal Government determine the level of funding that is sufficient to achieve their objectives? Specifically, if the States are paid on the basis of measured attributes of quality, can we assure that each State will ultimately receive sufficient funds from the Federal Government to provide the administrative quality that the Federal Government desires? In addition, can the Federal Government be assured that certain high-quality States will receive more money than is needed (to provide an incentive for other States to increase the quality of their administration).

With respect to this issue, there are three important points that we wish to emphasize. First, funding adequacy should not be considered a major issue. The important issue is to find a mechanism that promotes the effective, high-quality administration that the Federal Government desires. If the allocation mechanism accomplishes this objective, then it is allocating sufficient funds. Otherewise, it is not. Whether or not the actual level of dollars that would be transferred by the Government to some hypothetical State would allow that State to provide high-quality administration is irrelevant. Instead, if the Government sipmly monitors the measurements of quality and observes the level that it desires, than it can be assured that the mechanism is providing adequate funding.

Second, it is important to remember that in addition to allowing States to keep the residual, our proposal dictates that the States make up any shortfall out of general revenues. If our proposal were adopted, then regardless of whether an individual

8. Conclusion

The issue of Federal funding of UI administration is best understood as an example of the principal-agent problem. The Federal Government, acting as the principal, charges States (its agents) with the responsibility of administering a high-quality UI program, and it provides the States with the means to do so. The precise relationship between funding levels and State performance gives States incentives to provide high or low quality service, efficient or wasteful administration, and/or continuous improvement or stagnation. Whether by design or by accident, the incentives are always inherent in the funding mechanism. We have argued that these incentives should be acknowledged and that the system should be designed with an explicit intention to structure incentives in accordance with the goals of efficient, low-cost administration, high quality service, and continuous improvement through innovation.

We have outlined one simple funding mechanism that accomplishes these three goals and also allows the Federal Government to compensate States with inherently high cost structures or during deep recessions. This mechanism has two important characteristics. First, States must be permitted to keep any unspent residual allocations. This feature motivates low cost administration and provides incentives to undertake investments aimed at lowering costs in the future. Second, the Federal Government must measure the quality of service and reward it. Payments to the States should be in proportion to achieved levels of quality. This policy and the credible promise of its continuation provides powerful incentives to maintain high quality service in the present and advance performance over time.

The recommended funding mechanism also allows the Federal Government to subsidize high-cost States, but it is important that it do so by making fixed payments that are unrelated to actual costs. For example, it can compensate less populated States or those with higher insured unemployment rates, but it should not simply write checks to States that spend more resources on UI administration. States with high unemployment rates would receive the funds needed to fund their programs. But, they would receive these funds because they have high unemployment rates, not because the actual amount of money they spent to administer their program was high.

Finally, with our mechanism in place taxpayers can be motivated to provide additional encouragement because all cost savings would flow to their State treasuries. The Federal Government can facilitate this process by producing periodic reports that compare the performance of State UI systems.

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DESIRED LEVELS OF ACHIEVEMENT				
#	ITEM	MEASURE	MIN/<MAX>	LIMIT *
	Initial Claims			
1.	Performance	Confirmed issues	<3/100>	
2.	**Intrastate**	**First payments**	**87%**	**14/21 days**
3.	**Intrastate**	**First payments**	**93%**	**35 days**
4.	**Interstate**	**First payments**	**70%**	**14/21 days**
5.	**Interstate**	**First payments**	**78%**	**35 days**
6.	UCFE	First payments	70%	14/21 days
7.	UCFE	First payments	78%	35 days
8.	Weeks Claimed	CWC affects	<7%>	
	Nonmons (Intrastate)			
9.	Performance-sep.	Acceptable cases	75%	
10.	Performance-nonsep.	Acceptable cases	80%	
11.	Promptness	Determinations	80%	Timely
12.	Comb Wage Clms.	Wage transfers	75%	Timely
	Appeals			
13.	Performance	Cases/score	80%/80	
14.	**Lower Auth. prompt**	**Decisions**	**60%**	**30 days**
15.	**Lower Auth. prompt**	**Decisions**	**80%**	**45 days**
16.	Higher Auth. prompt	Decisions	40%	45 days
17.	Higher Auth. prompt	Decisions	80%	75 days
	Tax			
18.	Status Determination	Employer liability	80%	180 days
19.	Field Audits	Penetration	4%	
20.	Report Delinquency	Employer filings	95%	End of Qtr
21.	Collections	Accounts collected	75%	150 days
	Fund Mngmnt			
22.	Deposit Promptness	Collected taxes	90%	3 days
23.	Clearing Acct Timing	Funds on deposit	<2 days>	
24.	Withdrawal Timing	Fr withdrawal to paymnt	<1 day>	

* Waiting Week States/Non-Waiting Week States
Secretary's Standards indicated by **boldface type**

Table 1 reprinted from Fu Associates (1994)

THE FINANCING STRUCTURE OF THE UNEMPLOYMENT INSURANCE SYSTEM

Stacey G. Grundman
June 1995

Stacey G. Grundman is a staff member of the Advisory Council on Unemployment Compensation. The views expressed in this paper are those of the author and do not necessarily reflect those of the members of the Council.

INTRODUCTION

The taxable wage base and tax rates established by the federal and state governments for the collection of Unemployment Insurance (UI) taxes are generally thought to be powerful tools that can be used to advance a range of policy, program and administrative goals. Changes in the taxable wage base and tax rate directly affect the revenues available to states to pay benefits and indirectly affect the amount available for the administration of the system. In addition, they affect the level of trust fund reserves. Adequate reserves are needed to maintain trust fund solvency and a *forward-funded* system. A forward-funded system accumulates reserves that can be drawn upon when demand increases during recessionary times. This helps to maintain consumer purchasing power and contributes to economic stability. Thus, adjustments in the taxable wage base and tax rate affect the ability of the UI system to meet its two primary goals: (1) "the provision of temporary, partial replacement of wages as a matter of right to involuntarily unemployed individuals who have demonstrated a prior attachment to the labor force" and (2) "the accumulation adequate funds during periods of economic health in order to promote economic stability by maintaining consumer purchasing power during economic downturns" (Advisory Council on Unemployment Compensation 1995, 8).

While both the taxable wage base and employer tax rate may effect UI program outcomes, no mechanism currently exists for influencing the average employer tax rate in the states on a broad scale. The Federal Unemployment Tax Act (FUTA) tax credit, however, virtually ensures that changes in the federal taxable wage base will have a direct effect on states' taxable wages bases. The effects of such changes in the federal taxable wage base on UI program outcomes and the influences of the financing structure of the UI system are the focuses of this paper.

The paper begins with an overview of the financing structure of the UI system and then presents some of the advantages and disadvantages of increasing the taxable wage base. First, it presents empirical research that examines the effects of changes in the state taxable wage base and tax rate on various measure of UI program outcomes. It then looks at changes in the taxable wage base and the proportion of covered wages in a historical context and discusses some of the effects of a low taxable wage base on low-wage workers.

The next section of the paper explores the opposition to increases in the taxable wage base

stemming from the inclusion of the UI trust fund in the federal unified budget and the constraints of the budget process. Finally, the issue of evaluating administrative funding levels is raised and a framework for linking state funding levels to performance is discussed. The paper then concludes.

UI FINANCING: BACKGROUND

The Unemployment Insurance system is financed through a combination of federal and state payroll taxes. The federal payroll tax, established by the Federal Unemployment Tax Act (FUTA), is currently set at 6.2 percent of the first $7,000 of an employee's salary.[1] Employers in states with Unemployment Insurance (UI) programs that meet specified federal guidelines can receive a 5.4 percent credit towards their FUTA tax payment. The resulting net tax rate of .8 percent yields an employer cost of $56.00 per employee earning a minimum of $7,000. Federal revenues finance the state and federal administrative costs of the UI system, the federal portion of the Extended Benefits program, loans that are provided to states with insolvent trust funds, and other related federal costs.[2]

State revenues finance the payment of regular UI benefits and the state portion of Extended Benefits. States set their own taxable wage bases and tax rates, but must meet the following federal guidelines to receive the federal tax credit: (1) the state taxable wage base must be no less than the federal taxable wage base; (2) state tax rate *ceilings* must meet a federally specified minimum; and (3) state tax rates are required to be experience-rated.[3]

Today, 41 states have taxable wage bases above the federal minimum of $7,000 and 18 have indexed their taxable wage base to the average annual state wage. Table 1 provides a list of state taxable wage bases for 1995.

Most states also use a series of tax rate schedules that allow them to shift from one schedule to another depending on the solvency of their trust fund. During periods of low unemployment when trust fund reserves are generally high, for example, a favorable tax schedule (with lower tax rates for all experience rating levels) would be used. Some states also assess solvency surtaxes when trust fund reserves decline. As a result of the range of state taxable wage bases across states and the range of tax rates across *and* within states, the amount of state UI

taxes paid by individual employers varies greatly.

Revenue from the FUTA tax is credited to three federal UI trust fund accounts: the Employment Security Administration Account (ESAA), which finances both state and federal administrative costs; the Extended Unemployment Compensation Account (EUCA), which pays 50 percent of Extended Benefit payments; and the Federal Unemployment Account (FUA), which provides loans to states experiencing insolvencies in their accounts. State revenues are credited to 53 individual state accounts.[4]

Current law allocates 80 percent of the FUTA tax receipts to the ESAA—up to a ceiling of 40 percent of the federal appropriation level. If the ESAA is above its statutory limit at the beginning of any fiscal year, excess funds are transferred to the EUCA. Funds for administrative grants to states, the major component of the ESAA, are limited to 95 percent of the estimated annual revenue expected to flow into the ESAA.

Twenty percent of the FUTA tax receipts are credited to the EUCA, up to a ceiling of 0.5 percent of total wages in covered employment from the previous year. In addition, as stated above, the EUCA receives excess funds from the ESAA as long as it remains below its statutory ceiling. If both the ESAA and EUCA have reached their maximums, additional FUTA revenues flow to the FUA. The FUA ceiling is 0.25 percent of total wages in covered employment in the preceding calendar year.[5] If all three accounts are above their statutory ceilings at the start of a fiscal year and all outstanding advances from the general fund have been repaid, excess FUTA revenues are designated to be distributed to state trust fund accounts according to the proportion of covered wages in the state.[6] The status of the three accounts funded by FUTA for FY 1994 is summarized in Table 2.

GROUNDS FOR INCREASING THE TAXABLE WAGE BASE

The discussion that follows focuses on arguments for raising the federal taxable wage base. It begins with a presentation of empirical research that tests whether increases in a state's taxable wage base and tax rate can affect a number of state program outcomes. It continues with a discussion of the federal taxable wage base level in a historical context, and concludes by pointing out the inequitable impact of a relatively low taxable wage base on low-wage workers.

Increasing the State Taxable Wage Base Affects Program Outcomes

Empirical research was undertaken to examine systematically the effects of changes in a state's taxable wage base and tax rate on trust fund solvency, receipt of benefits, and benefit levels. The results indicate that increases in a state's taxable wage base can produce increases in the state's reserve ratio—improving the forward funding of the system and increasing its capacity to inject money into the economy during periods of economic downturn. The analysis also reveals that increases in the taxable wage base are associated with slight increases in UI benefit levels. The model and the results are described in greater detail below.

The Model

Five regression equations were used to examine each of the following UI outcomes: (1) the reserve ratio as a measure of trust fund solvency;[7] (2) the actual benefit recipiency rate;[8] (3) the percentage of the unemployed who were UI claimants (IU/TU);[9] (4) the maximum weekly benefit amount; and (5) the average weekly benefit amount. In the analysis, the state taxable wage base is measured as the difference between the state taxable wage base and the required federal wage base. The employer tax rate is measured as the ratio of total employer taxes paid to taxable wages. The means for each of these measures, for the states and years included in the model, can be found in Table 3.[10] The analysis used a fixed effects regression model, and a database that included annual, state level data for the 50 states and the District of Columbia from 1978 to 1990.[11]

The Results

The Taxable Wage Base The empirical analysis revealed that the primary effect of increasing the taxable wage base is a significant increase in a state's reserve ratio. Results also indicate a small but positive relationship between the taxable wage base and both measures of benefit generosity. These results are presented in Table 4. According to the model, a $1,000 increase in the taxable wage base would increase a state's reserve ratio by an average of 0.14. (See column 1 of Table 4.) This finding supports the view that increases in the taxable wage base would help states to increase trust fund reserves, thereby improving the system's ability to

achieve one of its fundamental goals—providing economic stabilization.

Results indicate, in addition, that increases in the taxable wage base would be expected to result in slight increases in benefit levels. According to the model, a $1,000 increase in the taxable wage base would, on average, increase the maximum weekly benefit level by $3.70 and the average weekly benefit level by $1.80. (See columns 4 and 5 of Table 4.)

The equations measuring the affect of changes in the taxable wage base on benefit receipt produced unexpected results. The model suggests that increases in UI tax revenues generated by raising the state taxable wage base produce slight decreases in both actual recipiency and the IU/TU ratio. A $1,000 increase in the taxable wage base would be expected to decrease the number of people filing for and receiving benefits by .38 and .39 percentage points, respectively. (See columns 2 and 3 of Table 4.) While the negative relationship is counterintuitive, if taken at face value the small coefficient suggests that the impact of changes in the taxable wage on recipiency and the UI/TU are minimal.

Employer Tax Rates The empirical analysis also revealed statistically significant relationships between employers' tax rates and four of the five state UI outcomes examined.[12] The relationships, however, are negative—contradicting the expectation that increased revenues would increase reserves, recipiency, and benefits. The most likely explanation for these seemingly perverse results is that the average tax rate may be an endogenous variable. If the tax rate is partially determined by the dependent variables, it becomes difficult to isolate the its effects on those variables. In addition, the tax rate is highly cyclical—further complicating the task of isolating its effects.

National Effects Regression results were used to simulate the effects of increases in the federal taxable wage base on the national reserve ratio. State reserve ratios were weighted by total state wages to produce the national averages presented in Table 5. The calculations assume that an increase in the federal taxable wage base would produce increases in states with taxable wage bases below the new federal level. For example, a $1,000 increase in the federal taxable wage would result in increases in the taxable wage bases of the 12 states currently at the federal level. The calculations suggest that increases in the states' taxable wages bases resulting from

a new federal taxable wage base set at $8,000 would increase the reserve ratio by .05 and that a federal taxable wage base of $10,000 would increase the reserve ratio by .22. The effects of incremental increases in the federal taxable wage base are greater at higher wage base levels because more states would be required to raise their taxable wage base in order to match the federal level. That is, the effects of a $1,000 increase in the taxable wage base from $8,000 to $9,000 would be greater than the effects of at $1,000 increase from $7,000 to $8,000 because it would affect more states.

Proportion of Covered Wages at Historical Low

For reasons to be discussed later in this paper, it is difficult to evaluate whether the FUTA tax generates enough revenue to fund sufficiently the administration of the UI system. The proportion of covered wages subject to UI taxes and the per worker cost of the FUTA tax over time, however, are known. By examining these trends it is possible to diffuse perceptions that increases in the taxable wage base would produce a historically high tax burden.

There have been only four changes in the federal taxable base in its more than 60 years in existence. These increases have not kept pace with increases in covered wages and, as a result, the proportion of wages on which taxes are paid has declined. This decline is illustrated in Figure 1.

The original unemployment provisions contained in the Social Security Act of 1935 called for a federal tax on employers equal to 1 percent of total payroll beginning in 1936 that would be increased to 2 percent in 1937 and to 3 percent in 1938. Employers could receive a credit of up to 90 percent of their federal tax obligation for their contributions to approved state unemployment compensation funds.

The Federal Unemployment Tax Act of 1939 reduced the taxable wage base from total payrolls to the first $3,000 paid to each employee.[13] At the time this change reduced the total amount of covered wages by only 8 percent. Over time, however, the impact of the $3,000 taxable wage base limit on FUTA tax revenues increased. As total wages increased, the proportion of taxable wages decreased. While in 1948, about 82 percent of all covered payrolls were subject to the FUTA tax, by 1969, only half of all payrolls were covered. Federal

legislation increased the taxable wage base to $4,200 in 1972. to $6,000 in 1978, and to $7,000 in 1983. In 1993, the most recent year for which data were available, the ratio of taxable wages to covered wages had eroded to 36 percent, the lowest level in history.

In addition to increases in the taxable wage base, increases in the net tax rate have been adopted periodically to cover growing administrative costs due to inflation, to support the Extended Benefits program, and to maintain funds for loans to state trust funds.[14] Table 6 depicts the changes in the FUTA wage base and tax rate, as well as the inflation adjusted per-worker cost over time.

The inflation adjusted per-worker UI cost illustrates how employers' federal UI tax burden has fluctuated with changes in the tax rate and federal wage base over time. This employer cost measure has declined substantially from $93.00 per worker in 1978 (when the taxable wage base was increased from $4,200 to $6,000) to $56.00 per worker in 1993. Consequently, an increase in the federal taxable wage base is unlikely to produce historically high federal UI tax costs for employers.

A Low Taxable Wage Base Has Inequitable Effects on Low-Wage Workers

The taxable wage base also affects the relative tax costs of low- versus high-wage workers to employers. When the taxable wage base is low in comparison to the average annual wage, employers with a high percentage of low-wage workers will be required to pay taxes on a higher proportion of their total payroll then employers with higher paid workers. The same tax, for example, must be paid on a worker earning $10,000 annually as must be paid on a worker earning $80,000. Consequently, as noted by Hammermesh (1989, 959), "assuming the workers' market wages reflect their skills and their value to the employer, the [taxable wage base] ceiling creates a powerful incentive to shift toward hiring higher-wage, more skilled employees." As a result, it is likely that either the demand for low-wage workers will fall or that their wages fall.

A low taxable wage base presents low-wage workers with an additional hardship. Research suggests that the incidence of a flat rate payroll tax, such a the FUTA tax, is often passed through from the employer to the worker in the form of lower wages (Anderson 1994). The regressive nature of the tax make this dynamic a greater burden for low-wage workers than for higher paid workers because the tax burden that is passed through represents a larger portion of their total earnings.

OPPOSITION TO INCREASES IN THE TAXABLE WAGE BASE: EFFECTS ON TRUST FUND BALANCES

The preceding discussion argues that increases in the federal taxable wage base would generate a wide variety of improvements program outcomes and would reduce the inequitable tax costs associated with low-wage workers without creating a historically high tax burden for employers. This approach, however, is complicated by the direct effects that increases in the FUTA wage base have on the federal UI trust fund. Barring a corresponding decrease in the FUTA tax, an increase in the federal taxable wage base will increase the flow of funds into the federal accounts in the UI trust fund—providing fodder for opposition to increases in the taxable wage base. Objections stem from the inclusion of the UI trust fund in the federal unified budget which limits the use of FUTA funds despite the fact that they are earmarked for the financing of the UI system.

The Federal Budgeting Process

Funding levels for the federally financed portion of the UI system are determined by the federal budget and appropriations process. The current budgeting system is workload-driven, based on the number of UI claimants and the number of covered employees. There are two categories of federal UI funding. *Base* funding includes all costs associated with the collection of taxes and an estimate of the minimum costs associated with the distribution of UI benefits. *Contingency* funding is provided when actual claims workload exceeds the base estimates.

The minutes per unit (MPU) that it takes for states to perform specific tasks, average state salaries, and national economic assumptions are used to estimate state costs for administering state UI programs.[15] Contingency workloads are funded at lower salary levels than those used for base funding under the assumption that additional workload is performed by temporary help with lower pay rates and benefit costs. The sum of the estimates for each of the states, theoretically, provides the basis for the annual budget request.

The funding available for administration of the UI system is limited to the appropriations level and not based on the balance of the federal UI accounts.[16] The inclusion of the UI trust fund in the federal unified budget violates the principal that trust fund balances are accumulated and held in trust solely for a specified purpose and presents a number of problems. First, the system can not respond to a justifiable demand from the states for increases in their administrative funding grants even if there are sufficient funds available in the trust fund account. Federal budget offsets must be identified before additional FUTA funds can be appropriated for program administration in order to maintain budget neutrality.[17] Secondly, the system loses its capacity to increase spending automatically during recessions. As a result, one of the principal functions of the UI system—economic stabilization—is threatened.

Revenues and State Administrative Funding Levels

The relationship between states' FUTA contributions and the funding they get back in administrative grants has varied over time. As shown in Figure 2, 85 percent of states' FUTA contribution were returned in the form of administrative grants in 1975; in 1988 this figure was only 43 percent; and in 1992 it rose to 63 percent. Typically, a higher percentage of states'

FUTA contributions are returned during periods of high unemployment. The years 1982 and 1983, however, represented an exception; a relatively low percentage of FUTA revenues was returned to the states despite very high unemployment levels.

The portion of FUTA contributions that states receive back from the federal government as *state UI grants* also varies greatly across states. For example, in FY 1993, the percentage ranged from 22 percent in Hawaii to 120 percent in Alaska. When total *state administrative grants* are considered, the percentages increase to 29 percent in Hawaii and 187 percent in Alaska (see Table 7).[18] The variation is due to both the size of the grants and the level of FUTA revenues.

The level of administrative funding relative to a state's claims workload has also varied over time. Historically, there appears to be an inverse relationship between funding per claim and the overall unemployment rate (see Figure 3). That is, funding per claim is lower during periods of high unemployment. This is due, at least in part, to the decrease in fixed overhead costs *per claim* when the number of claims increases. The level of UI administrative funding per claim also varies significantly across states (see Table 8). In 1993, funding ranged from a low of $101 per claim in Puerto Rico to a high of $490 in Alaska.

These observations illustrate the basis for opposition to increases in the taxable wage base. Most states contribute significantly more in FUTA revenues than they receive back in administrative grants. In 1993, for example (as shown in Table 6), half of the states saw less than 65 percent of their FUTA contributions returned in the form of administrative grants. There may even be skepticism from the *winners* who receive more than they contribute. They realize that the total amount of funding available for administration in any given year is influenced heavily by national economic constraints and the politics of the federal budget—and that they have little ability to know how their additional contributions will be used.

An Alternative Option

The inclusion of the UI trust fund in the unified federal budget creates a number of constraints on the funding of the UI system. In particular, it limits the use of FUTA revenues, that are collected and held in trust for the administration of the UI system. As a result, it may be difficult

to justify policies that increase FUTA revenue collections by placing an additional tax burden on employers—including the use of increases in the federal taxable wage base to improve UI program outcomes.

It is possible, however, to create revenue neutral increases in the federal taxable wage base by implementing corresponding decreases in the net FUTA tax rate. For example, a $2,000 increase in the taxable wage base to $9,000 and a decrease in the net FUTA tax rate to .6 percent would produce revenues roughly 5 percent less than under the current structure.[19]

This issue, however, raises a somewhat separate question. If the constraints of the budget process were removed, would it be advisable to provide additional federal funds to the states for the administration of their UI programs? The following section attempts to address this issue by considering the factors that can be used to evaluate whether administrative funding levels are sufficient.

ADMINISTRATIVE FUNDING LEVELS: PERFORMANCE AND EFFICIENCY

Determining whether additional funds would help states to improve the administrative outcomes of their UI programs requires assurances that funds are being used efficiently to produce desired outcomes. The absence of incentives for efficient behavior makes it impossible to determine whether poor outcomes are due to inadequate funding or to other factors that shape performance. This section discusses the current process for allocating administrative funds to the states, suggests the need for efficiency incentives in the allocation process, and presents some general principles for developing a set of administrative outcome measurements that could be linked to state administrative funding levels. Such measurements systems are needed to prevent efficiency incentives from threatening program quality.

Allocating Administrative Funds

The budget for administrative funds is determined, as discussed above, by a formula based on estimated workload and is subject to the federal budget appropriations process. State performance outcomes are not considered when the overall funding levels are determined, nor are they considered in the allocation of funds to the states. Furthermore, the formula used to distribute

administrative funds to the states lacks incentives for efficiency because more funds are provided to states that require more time to perform administrative tasks. The lack of efficiency incentives in the current administrative funding process makes it difficult to determine whether funding levels are sufficient for states to perform at desired outcome levels.

Some believe that higher quality programs must be more expensive to run because improving accuracy, timeliness, or other aspects of performance requires costlier staff, computer equipment and other resources. This type of relationship implies that decreases in funding would produce declines in some aspects of program performance. However, in a study of the relationship between program costs and quality, Vroman (1993) concluded that there is no statistical evidence to support the view that administrative costs are positively related to performance.[20] Additional studies have examined the implications of a funding system based on average costs per unit of workload of high quality performance states.[21] The results suggest that many states that administer high quality programs have relatively low costs.

Linking Performance, Efficiency and Administrative Funding

Efficient program administration is necessary to determine whether administrative funding levels are adequate.[22] The relationship between funding and performance is unclear. No research to date has addressed the key question of whether additional funding can improve poor performance.[23] It is apparent, however, that if funds are being spent wastefully and programs are not run efficiently, that there can be no basis for evaluating this question.

Davidson and Martin (1994) and Parsons (1994) have proposed similar conceptual frameworks for an allocation system that would promote efficiency. Both recommend that states be allowed to keep the savings generated by cost-cutting innovations in the administration of their UI programs—they refer to this provision as a *residual contract.* Allowing states to keep unused funds, rather than requiring that they be returned to the federal treasury, would encourage efficient behavior. For a residual contract to be effective, however, the allocation of funds cannot be based on costs. Such an allocation system would undermine states' incentives to devise and implement cost-cutting techniques. Consequently, both papers suggest the use of a "pay for performance" system in conjunction with the residual contract. Under such a system, funds

would be allocated based on state performance and states would be allowed to keep any residual savings. "If a state chooses not to adopt some cost reducing innovation it forgoes revenue. By the same token, any state that chooses to overlook some quality enhancing opportunity will receive a lower allocation of administrative funds than it would have received had it pursued the opportunity" (Davidson and Martin 1994, 24-25). Pay for performance would also encourage states to align their goals and efforts with federal priorities and, as a result, help to promote the national interest which those federal priorities represent.

Outcome Measures

An administrative funding system that promotes efficiency requires a viable outcome measurement system that can be used by the federal government to ensure that incentives for efficiency do not encourage states to sacrifice program quality. An appropriate outcome measurement system could help prevent an erosion of program quality when states are faced with incentives to cut costs. The primary purpose of the current "system" for outcome measurement—which is actually an extensive collection of federal programs that monitor, evaluate, or impose requirements on the states—is, however, to direct and inform program improvement efforts. In most cases, there is little threat of sanctions or other consequences if states fail to meet standards or if performance inadequacies are uncovered. While a comprehensive review of all current federal monitoring systems would be useful, it is beyond the scope of this paper. This paper does, however, suggest that federal efforts to measure state UI programs should be limited to areas that affect the fundamental goals of the UI system and where there is a potential divergence of national and state interests. There is no need for federal monitoring of state performance in areas where state interests are the same as national interests. In addition, the importance of each outcome will be raised if the federal review system is limited to only the most important program outcomes.

Many of the measures in the federal Quality Control program, for example, focus on efforts to reduce excess payments of benefits or to increase revenues for state trust funds. Since it is advantageous for individual states to pursue these ends, there appears to be little need for federal monitoring in these areas.[24]

The federal government, however, should measure essential program outcomes where national and state interests may not coincide. This framework supports federal monitoring of eligibility guidelines and other program areas where states may respond to interstate economic pressures to enhance their states' business climates by adjusting policy in ways that may undermine national objectives. For example, performance measures can be used to guard against the following means of state cost reduction: unreasonably high eligibility standards, inappropriately low benefit levels, the provision of limited administrative services which may make it difficult for individuals to collect benefits, or other reductions in services.

Outcome measures could also be used to ensure that individuals have adequate access to the UI system, including the ability to enter and fully participate in the system and to monitor state levels of forward-funding.

CONCLUSIONS AND POLICY IMPLICATIONS

The empirical research presented here suggests that a strategy of increasing the taxable wage base could be quite effective in increasing state trust fund solvency and the degree of forward funding in the system—a fundamental goal of the UI system. Furthermore, increasing the taxable wage base could have the added effect of reducing the inequities that result from the current low taxable wage base, since it is a disproportionaly high percentage of the wages of low-wage workers.

With the inclusion of the UI trust fund in the unified federal budget, however, increases in the federal taxable wage base would generate more FUTA revenues without guaranteeing that additional funds would be made available to the states. Removing the trust fund from the unified budget is one solution to this problem. It is unlikely, however, to be a viable option in the current political and economic climate. Alternatively, this source of opposition can more easily be remedied by a decrease in the FUTA tax rate to offset the wage base increase. As discussed throughout this paper, the advantages of increasing the taxable wage base can largely justify such an action.

TABLE 1. State Taxable Wage Base, 1995

State	Taxable Wage Base
Hawaii*	25,500
Alaska*	23,900
Idaho*	20,400
Washington*	19,900
Oregon*	19,000
New Jersey*	17,600
Rhode Island*	16,800
Utah*	16,500
Nevada*	16,400
Montana*	15,500
Minnesota*	15,300
Iowa*	14,200
Virgin Islands*	13,900
New Mexico*	13,500
North Carolina*	13,500
North Dakota*	13,400
Wyoming*	11,900
Massachusetts	10,800
Oklahoma*	10,700
Wisconsin	10,500
Colorado	10,000
District of Columbia	10,000
Michigan	9,500
Arkansas	9,000
Connecticut	9,000
Illinois	9,000
Ohio	9,000
Texas	9,000
Delaware	8,500
Georgia	8,500
Louisiana	8,500
Maryland	8,500
Missouri	8,500
Alabama	8,000
Kansas	8,000
Kentucky	8,000
New Hampshire	8,000
Pennsylvania	8,000
Vermont	8,000
Virginia	8,000
West Virginia	8,000
Arizona	7,000
California	7,000
Florida	7,000
Indiana	7,000
Maine	7,000
Mississippi	7,000
Nebraska	7,000
New York	7,000
Puerto Rico	7,000
South Carolina	7,000
South Dakota	7,000
Tennessee	7,000

NOTE: An asterisk (*) denotes that state has indexed its taxable wage base to average wages.
SOURCE: National Foundation for Unemployment Compensation and Workers' Compensation (1995, 9).

TABLE 2. UI Trust Fund Account Status, FY 1994 (billions of dollars)

Account	Balance at Start of FY	FUTA Income	Balance at End of FY	Statutory Ceiling
ESAA	2.2	5.5	2.4	1.5
EUCA	0.9	1.1	1.0	11.2
FUA	4.9	0.0	5.5	5.6

NOTES: For FY 1994, ESAA was .9 billion above the ceiling. Excess was transferred to EUCA at beginning of following fiscal year. The ESAA ceiling is based on 40 percent of $3.7 billion, the FY 1994 appropriation level. The EUCA and FUA ceilings are based on .5 and .25 percent, respectively, of $2,247.2 billion, the total wages from covered employment in 1993.

SOURCE: U.S. Department of Labor, Unemployment Insurance Service, 1995

Table 3. Means of Key Variables from Regression

Variable	Mean
Explanatory Variable:	
State Taxable Wage Base over Federal Level	1,644.95
Effective Employer Tax Rate	.025
Dependent Variable:	
Reserve Ratio	1.38
Recipiency	.30
IU/TU	.35
Maximum Weekly Benefit Amount	156.09
Average Weekly Benefit Amount	121.33

NOTE: Data is for 1978 to 1990 and includes 50 state and the District of Columbia.
SOURCE: Calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a, b, 1995a, b), and U.S. General Accounting Office (1993).

TABLE 4. Generalized Least Squares Regression Results, 1978-1990

Explanatory Variables:	Dependent Variables: Reserve Ratio	Recipiency	IU/TU	Maximum Weekly Benefit Amount	Average Weekly Benefit Amount
State Taxable Wage Base Over Federal Level	0.00014(.00)	-0.00039 (.01)	-0.00038(.02)	0.0037(.00)	0.0020 (.00)
Employer Tax Rate	-0.19 (.00)	-0.1.84 (.00)	-1.96 (.00)	-0.43 (.74)	-2.15 (.01)
Percent of Labor Force Unionized	-2.95 (.00)	33.40 (.00)	54.19 (.00)	31.71 (.24)	13.94 (.44)
Disqualification for Voluntary Quit	0.47 (.01)	-1.94 (.13)	-1.41 (.30)	22.19 (.00)	18.10 (.00)
Disqualification for Refusing Suitable Work	-0.18 (.14)	-0.98 (.29)	-1.16 (.23)	-5.98 (.10)	-2.88 (.23)
Disqualification for Misconduct	-0.11 (.41)	-1.18 (.26)	-2.28 (.04)	5.41 (.19)	-1.64 (.56)
State Government	0.027 (.55)	-0.011 (.98)	0.38 (.30)	1.44 (.29)	-0.54 (.55)
Required Base Period Wages for Benefits	-0.000071(.22)	-0.0022 (.00)	-0.0027 (.00)	-0.000075(.96)	-0.0029 (.01)
Total Unemployment Rate	-0.26 (.00)	-0.18 (.17)	-0.44 (.00)	-1.04 (.04)	0.64 (.06)
Denial Rate Per Initial Claim	-0.22 (.63)	-20.62 (.00)	-18.30 (.00)	7.70 (.58)	-0.83 (.93)
Percent of Employment Covered by UI	0.74 (.30)	4.47 (.41)	-3.09 (.59)	-66.27 (.00)	-31.14 (.028)
Average Weekly Wage	0.00038 (.73)	0.030 (.00)	0.028 (.00)	0.33 (.00)	0.32 (.00)
R-Squared Statistic	.35	.18	.20	.14	.25

NOTE: Significance levels are reported in Fixed effects regression analysis was used on data for the 50 states and the District of Columbia for the years 1978-1990. Missing data for the required base period wages for Michigan in the years 1982 and 1983 were estimated based on data from 1981 and 1984. State government for Nebraska was based on the political party of the governor because it has a unicameral legislature.

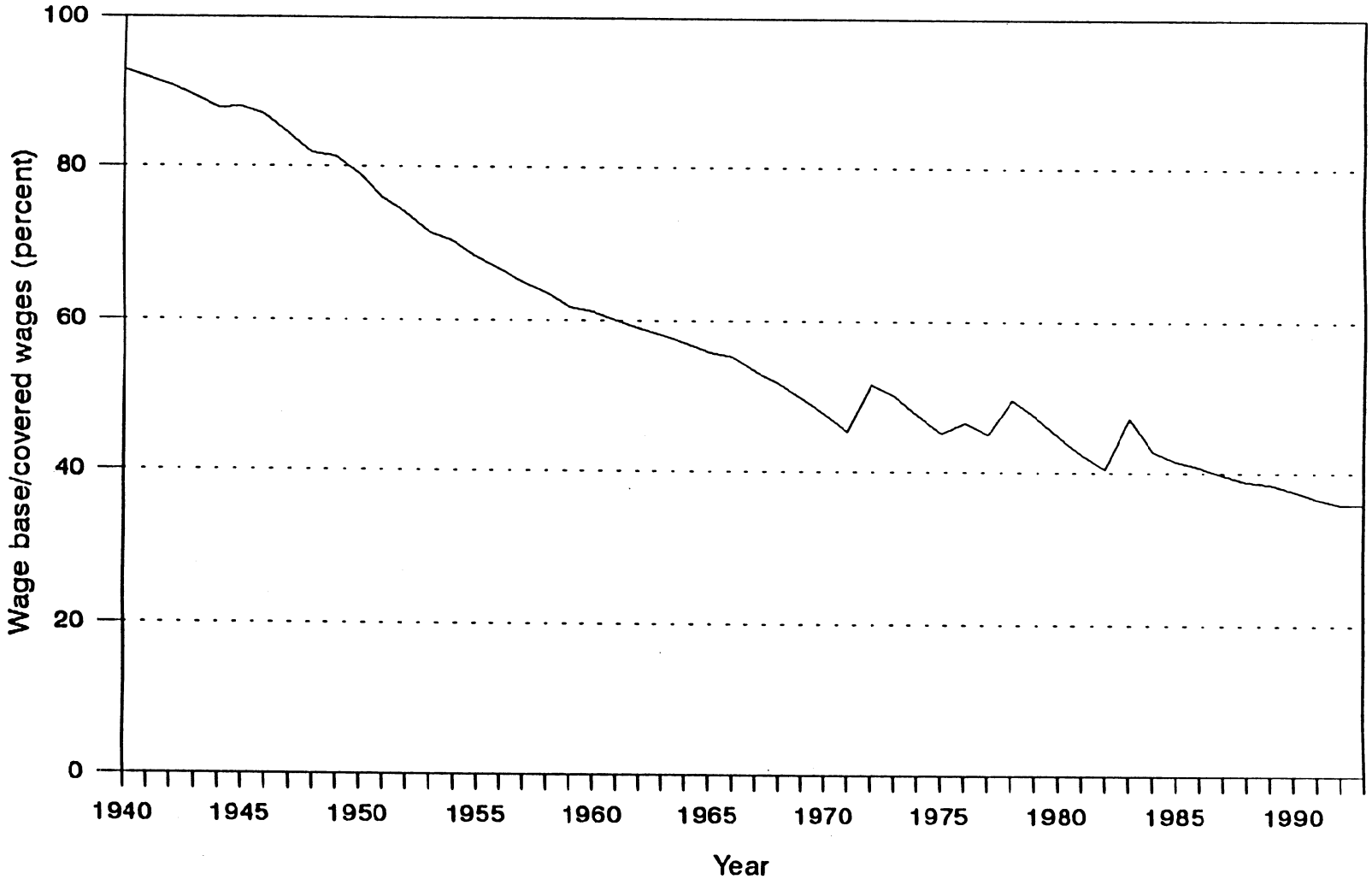
SOURCE: Calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

TABLE 5. Effects of Changes in the Federal Taxable Wage Base on National Reserve Ratio

Federal Taxable Wage Base	Reserve Ratio
7,000	1.25
8,000	1.30
9,000	1.37
10,000	1.47
12,000	1.70
14,000	2.94

SOURCE: ACUC staff calculations using database compiled from the following: Council of State Governments (1970-1994), U.S. Department of Labor (1994a,b, 1995a,b), and U.S. General Accounting Office (1993).

FIGURE 1. FUTA Wage Base as Percent of Total Covered Wages, 1940-1993



SOURCE: Advisory Council on Unemployment Compensation (1994).

TABLE 6. Federal Unemployment Tax Act Provisions, 1939-1993

Year Effective	Gross FUTA Tax Rate (percent)	Offsetting Credit (percent)	Potential Net Tax Rate (percent)	FUTA Wage Base (dollars)	Inflation-Adjusted per Worker Cost (1993 dollars[a])
1939	3.00	2.7	0.30	3,000	94
1960	3.10	2.7	0.40	3,000	59
1970	3.20	2.7	0.50	3,000	56
1972	3.20	2.7	0.50	4,200	72
1973	3.28[b]	2.7	0.58	4,200	79
1974	3.20	2.7	0.50	4,200	62
1977	3.40[c]	2.7	0.70	4,200	70
1978	3.40	2.7	0.70	6,000	93
1983	3.50	2.7	0.80	7,000	81
1985	6.20	5.4	0.80	7,000	75
1993	6.20	5.4	0.80	7,000	56

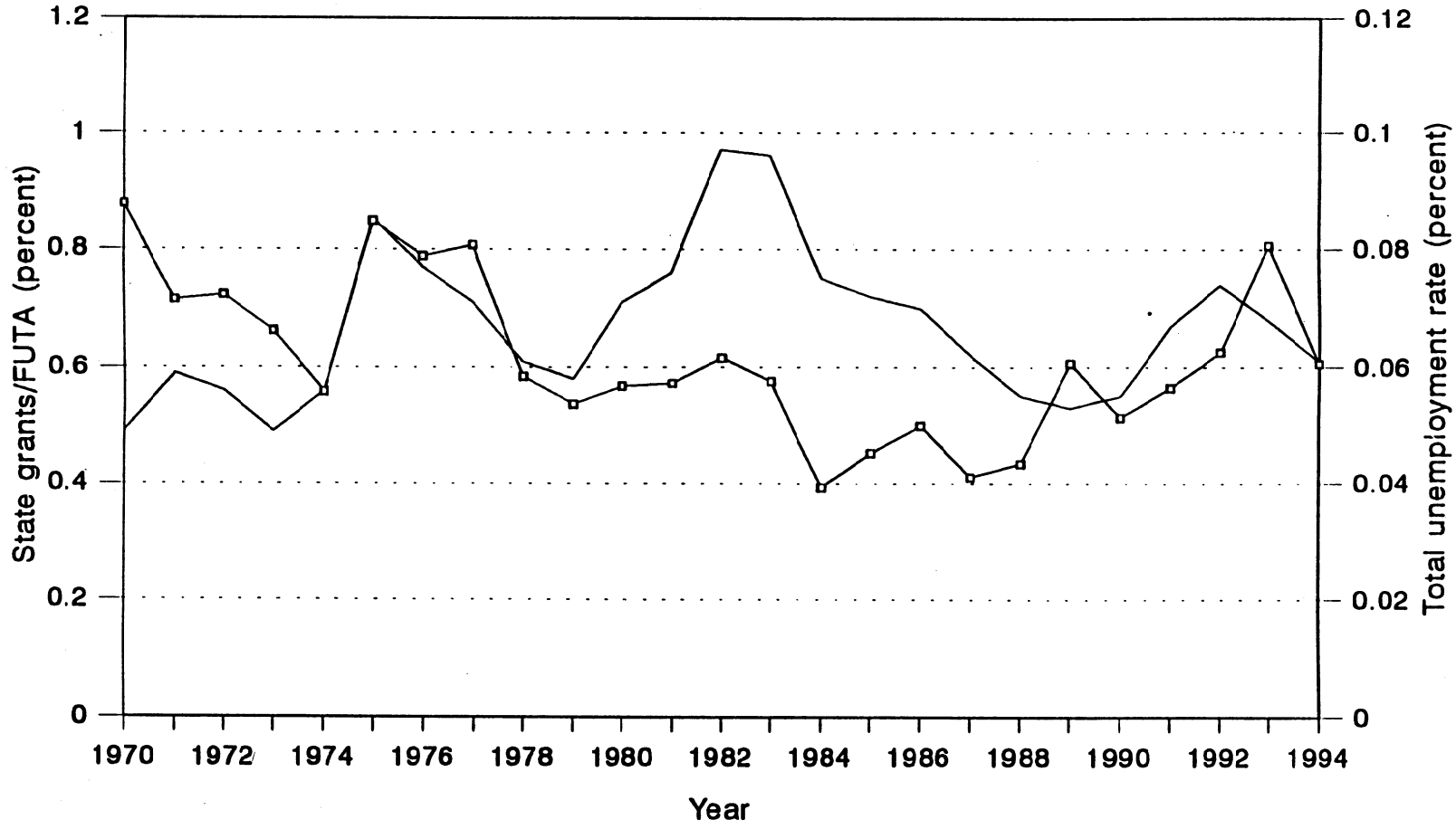
SOURCE: Advisory Council on Unemployment Compensation (1995)

[a] The calculation of the 1993 price index is based on 11 months of data.

[b] Reflects an 0.08 percent increase in federal unemployment tax in 1973 only to pay for additional benefit costs.

[c] A temporary surtax was enacted in 1977 for the Extended Benefits program; it was extended in 1987, 1990 and again in 1993. It is due to expire at the end of 1998.

FIGURE 2. State Grants as Percent of FUTA Contributions, 1970-1994



NOTE: 1993 FUTA data reflects a $967 million prior year FUTA adjustment.

SOURCES: Unpublished data from the UI Service and the Economic Report of the President (1994).

TABLE 7. State Administrative Grants and State UI Grants as Percent of FUTA Contributions, 1993

State	Administrative Grant/FUTA (percent)	Rank	UI Grant/ FUTA (percent)	Rank
Hawaii	28.6%	1	22.0%	1
Indiana	41.7%	2	25.3%	3
Florida	41.9%	3	25.2%	2
Tennessee	42.2%	4	26.6%	4
Georgia	42.5%	5	27.4%	6
North Carolina	43.1%	6	27.5%	7
Virginia	43.7%	7	26.8%	5
Ohio	47.3%	8	29.9%	8
Texas	47.4%	9	30.0%	9
Kentucky	49.0%	10	31.0%	11
Arizona	51.8%	11	35.7%	19
Massachusetts	51.8%	12	38.2%	22
South Carolina	52.2%	13	34.5%	16
Colorado	53.0%	14	36.5%	20
Louisiana	53.3%	15	32.8%	14
New Mexico	54.7%	16	30.6%	10
Alabama	55.3%	17	36.8%	21
Iowa	56.5%	18	34.9%	18
Minnesota	56.7%	19	38.3%	23
Missouri	58.4%	20	40.7%	25
Oklahoma	59.2%	21	32.5%	13
Nebraska	59.4%	22	31.9%	12
Wisconsin	61.2%	23	43.6%	29
Mississippi	61.4%	24	39.9%	24
Arkansas	61.4%	25	41.1%	26
Maryland	62.0%	26	45.0%	30
Illinois	63.9%	27	46.0%	31
New Hampshire	65.2%	28	43.3%	28
Delaware	66.2%	29	47.4%	33
Nevada	66.5%	30	48.2%	34
West Virginia	70.2%	31	43.1%	27
Kansas	71.0%	32	34.7%	17
Michigan	75.5%	33	55.5%	38
New Jersey	75.7%	34	58.2%	40
New York	77.2%	35	58.6%	41
Pennsylvania	79.2%	36	59.8%	42
Oregon	81.0%	37	61.7%	44
Puerto Rico	83.8%	38	52.5%	36
Washington	85.3%	39	65.6%	45
District of Columbia	85.9%	40	56.6%	39
California	86.2%	41	68.6%	48
South Dakota	86.3%	42	34.5%	15
Utah	87.8%	43	46.9%	32
Vermont	98.2%	44	65.7%	46

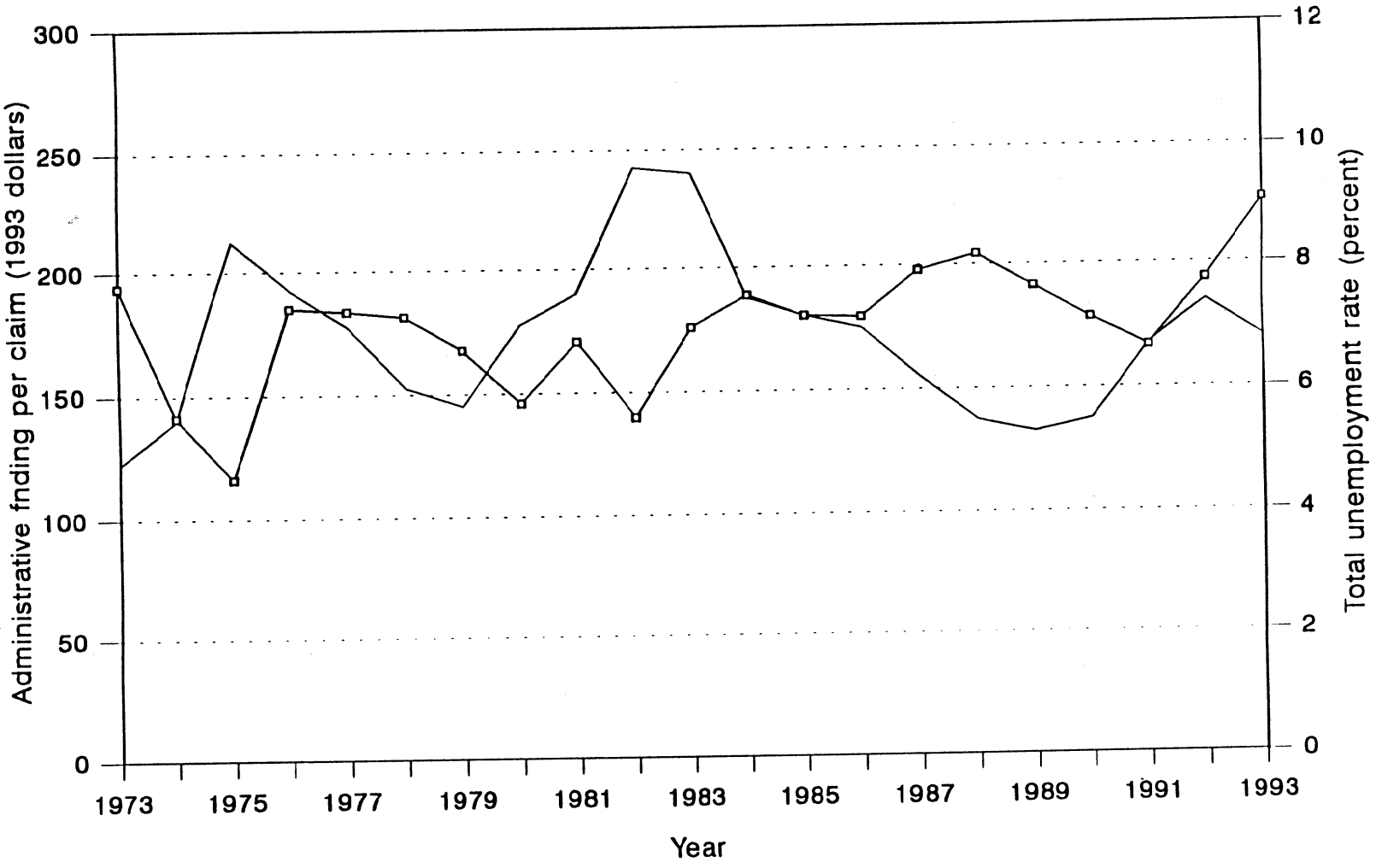
(continued)

TABLE 7. (continued)

State	Administrative Grant/FUTA (percent)	Rank	UI Grant/ FUTA (percent)	Rank
Maine	99.1%	45	73.4%	50
Connecticut	101.8%	46	82.9%	51
Wyoming	105.7%	47	55.2%	37
Montana	107.5%	48	52.0%	35
Idaho	112.3%	49	69.4%	49
Rhode Island	122.3%	50	98.7%	52
North Dakota	125.7%	51	60.2%	43
Virgin Islands	155.0%	52	66.8%	47
Alaska	186.7%	53	120.6%	53

NOTE: State FUTA revenues are estimates.
SOURCE: Unpublished data from DOL\ETA\UI Service\Division of Actuarial Services

FIGURE 3. UI Administrative Funding Per Claim, 1973-1993



NOTES: Administralive funding is based on state UI grants. Claims are based on new initial claims.
SOURCES: Unpublished data from the UI Service and Unemployment Insurance Required Reports.

TABLE 8. UI Administrative Funding per Claimaint, 1993

State	Claims[1]	State UI Grant	State UI Grant/ Claim
Puerto Rico	167.0	16,867.9	101
Tennessee	241.6	28,837.6	119
Georgia	287.7	40,932.2	142
Alabama	204.6	29,221.5	143
Kentucky	151.3	21,884.5	145
South Carolina	170.2	24,831.8	146
Arkansas	116.4	18,723.3	161
North Carolina	261.3	42,728.7	164
Iowa	104.2	18,836.3	181
Missouri	245.1	44,427.6	181
Ohio	368.9	68,723.3	186
Florida	373.8	70,330.5	188
Virginia	185.5	35,545.2	192
Indiana	160.7	30,878.9	192
West Virginia	64.4	12,442.5	193
Louisiana	123.8	24,075.4	194
Mississippi	91.9	18,094.9	197
Texas	544.7	107,381.7	197
Michigan	529.7	104,773.2	198
Illinois	531.8	113,866.7	214
Oklahoma	83.5	17,997.4	215
Wisconsin	211.9	46,380.5	219
Montana	30.8	6,914.0	225
Kansas	74.2	16,991.3	229
California	1831.3	430,950.7	235
New Jersey	391.6	92,870.2	237
Pennsylvania	538.4	133,749.6	248
Washington	265.6	66,711.3	251
Oregon	151.0	38,228.5	253
Arizona	106.4	27,470.2	258
Massachusetts	261.9	69,359.6	265
New Mexico	38.6	10,404.2	269
Nebraska	36.7	10,214.0	278
New York	696.8	202,054.9	290
Hawaii	41.8	12,201.7	292
Colorado	101.1	29,609.1	293
Maine	56.2	16,664.4	296
Maryland	154.5	46,485.1	301
Vermont	23.8	7,228.2	304
Connecticut	192.3	58,757.8	305
Delaware	24.1	7,441.8	308
Minnesota	116.5	36,183.1	311
Rhode Island	58.2	18,158.8	312
New Hampshire	31.8	9,948.8	313
Nevada	60.4	18,979.0	314
Idaho	44.4	14,167.2	319
Virgin Islands	4.0	1,336.2	338
South Dakota	11.8	4,278.3	362
Wyoming	15.3	5,801.1	378
North Dakota	16.9	6,563.4	388
Utah	39.4	16,124.9	409
District of Columbia	26.9	11,208.7	417
Alaska	38.9	19,049.6	490
United States	10,521.9	2,384,000.0	227

NOTE: Administrative funding is based on state UI grants.
SOURCE: DOL/ETA/UI Service/Division of Acutarial Services, Unemployment Insurance Required Reports
[1] Claims are based on new initial claims.

NOTES

1. Details regarding the changes in the taxable wage base and tax rate over time are discussed later in this paper.

2. FUTA revenues are also used for the following purposes: the Employment Service (ES); the collection of labor market information by the Bureau of Labor Statistics (BLS); and the collection of FUTA taxes by the U.S. Treasury.

3. Experience-rated taxes are based on an employer's use of the benefits in the UI system. An employer that has many former workers collecting UI benefits, in principal, will be assessed at a higher tax rate than an employer with few former employees collecting benefits. In practice, however, experience rating is far from complete.

The level of experience rating, or the degree to which UI benefit costs are assigned to the employer who generates that cost, is determined by the details of the state system. All states specify some circumstances under which benefits paid are not charged to the account of an individual employer, but instead are shared among all UI taxpayers. Costs are also shared by all UI taxpayers when employers' tax rates are too low to cover the benefits paid to their former employees. This situation arises when an employer is at the maximum tax rate. Finally, when an employer goes out of business and stops paying payroll taxes, the benefits collected by former employees must be covered by the system. All of these factors contribute to the *socialization* of benefit costs which reduces the degree of experience rating in the system.

4. Separate accounts are maintained for each of the 50 states, the District of Columbia, Puerto Rico and the Virgin Islands.

5. The current allocation formulas and ceilings for the three accounts were established by the Unemployment Compensation Amendments of 1992 (Public Law 102-318).

6. Between the years 1956 and 1958, $138 million was distributed to states under this provision (U.S. Department of Labor 1993, VII-16), but additional funds have not been distributed since that time.

7. The reserve ratio represents net trust fund reserves as a percentage of total covered wages.

8. This measure of recipiency is calculated as: (first payments x average actual duration)/total annual unemployment.

9. The IU/TU is the ratio of the number of UI claimants (the insured unemployed) to the number of unemployed job seekers (total unemployment). The distinction between the IU/TU ratio and recipiency is that the IU/TU ratio measures the percentage of the unemployed who have filed for UI benefits—it does not consider whether or not benefits were received. Recipiency only include claimants who actually receive benefits.

10. The other variables included in the model were: disqualification penalties for voluntary quits, refusal of suitable work, and misconduct; base period wage requirements to

receive minimum benefits; the percentage of initial claims that were denied; the total unemployment rate; the average weekly wage; the ratio of covered employment to total employment in the state; the percentage of state workers who were union members; and the relative power of the Democratic and Republican political parties in the state government. The means of these variables are also included in Table 3. All dollar value variables are expressed in 1993 dollars.

11. A fixed effects model was used in order to accommodate the panel data (e.g. multiple observations for each state over a given number of years). Unlike ordinary least squares (OLS) regression, the fixed effects model does not assume that all observations are independent of one another and, therefore, provides more reliable estimates of regression coefficients, standard errors, and the model's explanatory power.

Due to problems of data availability for a number of variables, the analysis was confined to the years 1978-1990. In addition, data from Puerto Rico and the Virgin Islands were excluded because of issues regarding data reliability.

12. Results did not indicate the existence of a significant relationship between the taxable wage base and the maximum weekly benefit amount.

13. Originally, this was done to match the tax base used for old age insurance contributions, in order to simplify federal employer tax collections and payment procedures for both programs (Blaustein 1993).

14. Tax rate adjustments included a 0.2 percent tax increase enacted in 1977 to generate revenues to repay a loan from the federal treasury to the Extended Benefits account, which had been depleted. The increase was intended to be temporary—once the loan was repaid, the increase was to terminate. In May 1987, the advances had been repaid and the 0.2 percent surcharge was due to expire at the end of the year. The Budget Reconciliation Act of 1987, however, extended this tax component through 1990 to offset some of the federal budget deficit. The surtax was extended again in 1990 to help finance the Emergency Unemployment Compensation program which was passed that year. A 1993 extension extended the surtax through 1998 for budget reconciliation purposes.

15. Until 1985, periodic studies were conducted to estimate the MPU for each of 17 specific tasks within each states. Since 1985, however, no studies have been performed.

16. While there is no *direct* link between trust fund balances and administrative funding levels, administrative funding may be threatened by competing budget priorities when account balances are low.

17. Inadequate levels of administrative funding may cause states to divert funds, designated for the payment of benefits, from their state trust funds to pay for administrative expenses, further eroding the financial integrity of the system.

18. State administrative grants include UI, ES, BLS and VETS funding. State UI grants are a subset that only include UI funding.

19. Estimates are based on unpublished data from the Bureau of Labor Statistics.

20. Vroman's model tested the ability of cross-state variation in administrative costs to explain the changes in several measures of quality in processing UI claims. The measures of quality were promptness of first payments, promptness of higher and lower authority appeals, and benefit quality control payment error rates. Cost measures were based on state salaries and workload mix.

21. Fu Associates (1994) calculated a national unit cost using data from 15 quality states for benefits and 20 quality states for taxes. Cook (1995) developed a measure of relative administrative efficiency and examined the relationship between efficiency level and a state's ability to meet specified standards for the timely delivery of UI services. Using these results, he calculated alternative allocations of funds that would enable all states to meet the performance standards if they adopted the behavior patterns of high performance states. The results suggest that total allocations could be reduced if all states were funded as adequately as the states that actually did meet the standards.

22. Efficient program administration is also desirable because it can reduce wasteful spending and program costs.

23. This fundamental question is raised in reference to many publicly-provided services. For example, will investing more money in school districts with poor performance records improve education for children in those schools?

24. Competitive pressures may, however, create a disincentive for states to enforce tax policy fully.

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Some Issues in Financing Unemployment Insurance

by

Wayne Vroman*

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*Senior Research Associate, the Urban Institute. This paper was prepared for the Advisory Council on Unemployment Compensation (ACUC). Opinions expressed in the paper are the sole responsibility of the author and do not necessarily represent the position of the Urban Institute, its sponsors or the ACUC.

Introduction

This paper surveys the financing situation of unemployment insurance programs in the United States. Prepared in conjunction with deliberations of the Advisory Council on Unemployment Compensation (ACUC), its objectives are twofold: (1) to introduce and survey the key topics in unemployment insurance financing and (2) to identify areas where our understanding of questions is limited and/or where previous research has reached conflicting conclusions. These areas may be subject to follow-up research or new research to be initiated by the ACUC.

The paper has five main sections. Section I introduces and describes the funding of the three tiers of unemployment insurance (UI): regular state UI that pays benefits to the unemployed for up to 26 weeks and is financed by state payroll taxes on covered employers; Federal-State Extended Benefits (EB) which can pay benefits for as many as an additional 13 weeks and is equally financed by the states and the federal government; and emergency benefits which can pay benefits for additional weeks to eligible claimants and is fully federally financed. Section II discusses the financing experiences of the regular UI programs with attention to the current recession and developments in the 1970s and 1980s. Section III surveys past research on UI financing and identifies topics where added research is needed. Section IV discusses experience rating of employer UI taxes. Section V discusses previous research on experience rating and identifies areas where added research is needed. Note that sections II through V focus on the regular state UI program which accounts for the bulk of benefit payments and generates the most complicated financing issues.

I. The Three Tiers of Unemployment Insurance

Jobless benefits are paid to unemployed workers under three

distinct UI programs. Regular state UI can provide up to 26 weeks[1] of benefits to an unemployed worker who meets monetary and nonmonetary eligibility criteria. States determine several important aspects of benefit payments, e.g., eligibility criteria, benefit levels and maximum potential benefit duration. At any given time 35 percent to 45 percent of persons officially counted as unemployed are UI claimants.

Regular state UI is financed by payroll taxes on covered employers. These taxes are experience rated, i.e., individual employers' experiences paying benefits have a strong influence on their UI tax rates. However, benefit experiences are not the only determinant of employer UI taxes. In all states there is a minimum and a maximum tax rate that limits the potential range of tax rates. Also, not all payments are assigned as the financial obligations of individual active employers. Three categories of benefits are generally covered by flat rate taxes levied on all covered employers: ineffectively charged benefits, non charged benefits and benefits charged to inactive employer accounts.[2] Thus experience rating is said to be imperfect. Details of experience rating systems in the states will be examined in Section IV.

Besides experience rated taxes most regular UI programs also have special taxes that become active when trust funds decline below certain levels. So called solvency taxes which are present in most states are automatically activated by triggers specified in state UI tax statutes. Usually solvency taxes are levied at the same rate on all employers, but they can be based on individual employer experiences.

Employer state UI payroll taxes are paid into state trust fund accounts maintained at the U.S. Department of the Treasury. Once tax receipts have been deposited into these accounts they can be withdrawn only to pay UI benefits. While in the trust funds the

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[1] Regular benefits can be paid up to 30 weeks in Massachusetts and Washington.

[2] These terms will be defined and discussed in Section IV.

deposits are invested in interest yielding U.S. debt obligations. Should large benefit outflows exhaust a state's trust fund, the state can borrow from a federal trust fund administered by the U.S. Treasury in order to continue to pay benefits. Eventually these loans must be repaid, and while outstanding they incur interest charges. Section II reviews in some detail the current situation along with the recent history of trust fund balances and borrowing.

The second tier of UI benefits is payments under the EB program. As noted it can pay up to an additional 13 weeks of benefits to workers who have exhausted their regular UI program entitlements. The financing of EB is shared 50-50 between the federal government and the states. The federal share of EB is financed from a federal trust fund account. The state share is financed like regular UI benefits, i.e., from state UI trust funds. Roughly half the states use experience rated taxes to finance their share of EB while about half use flat rate taxes.

The scale of the EB program declined in the early 1980s. The program is activated when unemployment in a state exceeds a statutory threshold. Utilization of EB has remained low since the early 1980s due to changes the trigger thresholds which made the program more difficult to activate and because the share of the unemployed claiming benefits from the regular UI program declined. In response to the decreased scale of EB availability the triggers were liberalized in federal UI legislation of 1992, but few states have made the necessary changes in their own laws to activate EB under the alternative triggers.[3]

In states where EB is not turned "on" an exhaustee of regular UI benefits can claim federal emergency benefits. This program, Emergency Unemployment Compensation (EUC), was enacted in 1991 and

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[3] Traditionally EB trigger calculations have been based on insured unemployment rates (or IURs). The IUR is the ratio of insured unemployment, i.e., UI claimants, to covered employment. The new, alternative triggers utilize total unemployment rates (or TURs), the unemployment rates for all workers aged 16 and older as measured in the monthly household survey of the labor force.

is fully federally financed. To date monies to finance EUC have been drawn from the same federal UI trust fund that finances the federal share of EB, the Extended Unemployment Compensation Account (EUCA). This trust fund is nearly empty as of early 1993 so that continued payments of EUC during the remainder of 1993 will have to draw upon federal general revenues.

Part of the reason for state tardiness in revising their EB triggers is related to financing considerations. If a worker with long term unemployment collects EUC there is no withdrawal from the state's UI trust fund as there is for the state share of EB.[4]

Although the current emergency benefit program is temporary in duration, some type of emergency federal program has been enacted in every recession since 1958. A new federal law has been required each time, and there have been delays in the start of emergency programs as details such as the duration of added entitlements are worked out.

In summary there are three separate tiers: regular UI, EB and emergency federal UI benefits (EUC in the present recession). Their sources of financing are respectively 100 percent state, 50-50 state-federal and 100 percent federal.

Benefit payments and tax receipts for all three tiers of UI have implications for the federal budget deficit because all state and federal UI trust funds are included in federal deficit accounting. Because of this, routine or non emergency changes in these programs have to be "financed" under terms of the Gramm-

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[4] There is currently a second set of financial considerations involving the interface between federally financed EUC and state financed regular UI benefits. Many workers with long term unemployment had much higher earnings in the base period that preceded their initial spells of unemployment in the current recession. Because their more recent base periods include substantial spells of unemployment, the associated lower earnings confers lower weekly benefits than entitlements based on the earlier base periods. As a result, many workers with the choice are opting to collect EUC rather than regular UI benefits. These decisions mean savings for state UI trust funds but extra costs for the federal EUC program.

Rudman-Hollings Act of 1985 and the Budget Enforcement Act of 1990. Any federally initiated UI benefit liberalization must be matched by other expenditure reductions and/or tax increases. The only exceptions to this budget discipline are changes designated as emergencies that can be deficit financed.

In addition to the 53 state UI trust funds that are the source of benefit payments for regular UI and half of EB, there are also three federal trust funds whose proceeds are used to finance program administrative expenses, long term benefits and loans to insolvent state UI programs. The Employment Security Administration Account (ESAA) finances both UI administrative expenses and the costs of the Employment Service. The Emergency Unemployment Compensation Account (EUCA) finances the federal share of EB plus EUC. The Federal Unemployment Account (FUA) provides loans to states with deficits in their regular UI trust funds.

The three federal UI trust fund accounts receive tax revenues from a federal payroll tax on covered employers. At present a tax of 0.8 percent is levied on the first $7,000 of annual earnings of each covered worker. Revenues from this tax total about $5 billion per year. Federal tax receipts are divided among the three trust funds according to set rules, and each trust fund has a statutory ceiling.[5] The rules that divide the federal tax receipts and set the ceilings are periodically revised. Should all three trust funds reach their ceilings, any excess receipts are slated for distribution to the state UI trust funds.[6]

At present the combined ceilings for the three total about $24 billion whereas actual balances at the end of 1992 totaled roughly $5 billion. Table 1 summarizes end of year balances for all three funds over the five calendar years 1988 to 1992. During 1992 the EUCA trust fund declined by about $7 billion and the FUA trust fund

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[5] For a summary of these rules in 1991 see Chart 4, p. 496, in U.S. House of Representatives, Committee on Ways and Means (1992).

[6] Distributions to the state UI trust funds did take place during the 1950s.

lost about $2 billion. The EUCA trust fund was essentially exhausted at the end of 1992.

Behind the three federal trust funds stands the general revenue taxing ability of the federal government. Loans from the U.S. Treasury will partially finance payments of EB and EUC in 1993. If the recession proves unusually persistent the FUA trust fund also may need U.S. Treasury loans in 1993, but this does not seem likely.

II. The Condition of the State UI Trust Funds

Revenues that fund regular state UI programs are obtained mainly from payroll taxes on covered employers. Tax receipts are deposited into state UI trust fund accounts maintained at the U.S. Treasury, accounts that are the source for benefit payments to eligible claimants.

The funding strategy for regular UI is usually characterized as pre-funding or advance funding. Trust fund balances are built up prior to recessions, drawn down during recessions and then rebuilt during the subsequent recoveries. This funding arrangement means the program acts as an automatic stabilizer of economic activity, i.e., it makes larger injections than withdrawals into the spending streams during recessions and larger withdrawals than injections during economic recoveries. The preceding characterization was less accurate during the recessions of the mid 1970s and the early 1980s because the trust fund balances were not adequate to pay regular UI benefits to all claimants. Large scale and persistent state borrowing took place.

During the current downturn the trust funds of the state UI programs have generally been adequate to meet demands for benefit payments. Between January 1991 and April 1993 only seven states required loans from the FUA trust fund, and only two states (Connecticut and Massachusetts) engaged in large scale borrowing. As noted, this recent situation stands in sharp contrast to the major downturns of 1973-1975 and 1980-1982. In both earlier periods

borrowing was much more widespread and larger in relative scale.

To place 1990-1993 trust fund borrowing experiences into a longer term historical perspective, Table 2 provides summary data which extend back over the 1970s and 1980s. The top panel in Table 2 summarizes state UI trust fund reserve balances at the end of four separate years; 1969, 1973, 1979, and 1989. These four dates were selected because they precede the onset of recessions and recession-related increases in the demand for UI benefit payments.

To understand the information summarized in Table 2 it will be important to introduce the concept of the reserve ratio multiple (also termed the high cost multiple). This a UI actuarial concept that assesses state reserve adequacy by taking into consideration three important factors: the balance in the state's UI trust fund, the scale of the state's economy and the state's own past experiences in paying UI benefits. The denominator in the reserve ratio multiple is the highest cost benefit payout period in the state's history. This is total benefit payouts over a twelve month period expressed as a percentage of covered wages for the same period. The range of high cost percentages extends from a low of 1.04 percent (in South Dakota between January and December 1964) to a high of 4.37 percent (in Rhode Island between January and December 1975). The highest cost period for the U.S. as a whole was 2.24 percent (between January and December 1975).

The numerator of the reserve ratio multiple, the reserve ratio, is the current trust fund balance divided by covered wages for the preceding year and expressed as a percentage. The ratio of these two ratios, the reserve ratio multiple, is thus a measure whose numerator incorporates information on both the UI trust fund balance and the scale of the state's economy (as approximated by covered wages) while the denominator is a measure of risk, the highest previous twelve month payout rate.

In the past some have advocated that states build trust fund reserves to levels that produce reserve ratio multiples of 1.5. This level implies that the fund balance equals 18 months of benefits if paid out at the historically highest payout rate. The

reserve ratio multiple has its critics as a measure of trust fund adequacy. Many practitioners feel the 1.5 reserve multiple standard is too conservative, i.e., a prudent state could function with a much lower trust fund balance and still have little or no risk of UI trust fund insolvency.[7]

With the preceding as background, the top panel of Table 2 shows arrays of reserve ratio multiples prior to each of the four economic downturns of the past two decades. Each row displays multiples for UI 52 programs, all save the Virgin Islands. The final entry for each row is the national reserve ratio multiple. From this last column as well as the distributions of state multiples it is clear that reserves were most ample at the end of 1969 and lowest at the end of 1979. Between 1979 and 1989 most states increased reserves substantially, and the national reserve ratio multiple roughly doubled, increasing from 0.41 to 0.85.

The lower three panels in Table 2 then summarize state borrowing experiences in the three most recent downturns. Each panel shows how many states needed loans and how many needed "large" loans. The 24 states that needed loans during 1974-1979 borrowed a total of $5.5 billion. Between 1980 and 1987 a total of $24.0 billion was borrowed. Borrowing between 1990 and April 1993 has exceeded $3.0 billion, and current projections are for total borrowing through the end of 1995 to reach only $6.4 billion.

The purpose of prefunding (or advance funding) UI programs is to have adequate reserves deposited in the trust funds to make benefit payments during recessions without resorting to borrowing (or at least large scale borrowing). By ranking states according to

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[7] Two criticisms are frequently made. First, the highest cost period is often so far in the past, e.g., January-December 1964 for South Dakota, that it may no longer be relevant as a indicator of risk. Second, because the multiple is a static concept it does not adequately recognize the dynamic response of taxes when trust funds are being depleted. A fast response of taxes can allow a state to function successfully with a lower trust fund reserve. Both of these arguments can be disputed. An empirical assessment of their validity would be useful.

their reserve ratio multiples, the bottom panels of Table 2 provide a convenient summary of the prevalence of borrowing according to an indicator of pre-recession reserve adequacy. In each episode, borrowing and large scale borrowing are most prevalent among states with low reserve balances prior to the downturn. States with reserve multiples of 1.0 or larger generally have been successful at avoiding borrowing. Those with multiples below 0.5 have been most likely to need loans and to need "large" loans.

Table 2 also illustrates that the 1.5 reserve ratio multiple guideline is not a foolproof indicator of reserve adequacy. There have been states that entered recessions with multiples above 1.5 that subsequently needed loans. Conversely, not all states with pre-recession multiples below 0.5 have needed loans. However, for identifying states at risk of needing loans and needing "large" loans, the reserve ratio multiple is a useful indicator.[8]

An interesting contrast emerges when borrowing during the 1980-1987 and 1990-1993 periods is compared. For reserve ratio multiples in both the 0.0 - .499 and 0.5 - .999 ranges note that the proportions that borrowed were much lower in the 1990-1993 episode. Further the proportions needing "large" loans were also much lower during 1990-1993.[9] The main reason for reduced borrowing activity among states with comparable pre-recession reserve multiples is the comparative mildness of the recent downturn relative to the back-to-back recessions of the early 1980s.

State-level information on UI trust fund reserves and

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[8] Regression analysis of the probability of a state needing a loan during a recession consistently shows a negative and highly significant coefficient on the pre-recession reserve ratio multiple.

[9] Clearly, the passage of a longer period of time can affect cumulative measures of borrowing activities. However, of the 31 programs that needed loans between 1980 and 1987, 29 borrowed between 1980 and 1983. Because the 1980-1987 borrowing was heavily concentrated early in the period, the 1980-1987 and 1990-1993 periods are more comparable than might initially be imagined.

unemployment in the current recession is displayed in Table 3. For each of the 53 UI programs the table shows reserves and reserve ratio multiples at the end of 1989 and 1992 and three year changes. Also included are an identifier for each of the 18 programs with indexed taxable wage bases and an indicator of recession-related unemployment growth, namely each state's 1990-1992 unemployment rate as a ratio to its 1987-1989 unemployment rate.

Note first the national aggregates at the bottom of Table 3. Total net reserves declined by about $11 billion over these three years, and the national reserve ratio multiple decreased by about one third from .85 to .57. At the end of 1992, however, only four states had negative net reserves.

Observe the large drawdowns of reserves in California and New York, both exceeding $2.5 billion, and the losses in Massachusetts, Connecticut and Pennsylvania. Combined, these five states accounted for $8.6 billion of reserve losses or 78 percent of the national total.[10] One indicator of the comparative shallowness of the downturn is the national unemployment rate ratio of 1.156, i.e., the national unemployment rate during 1990-1992 was only 15.6 percent higher than the 1987-1989 pre-recession average.

The state-level information can be organized in alternative ways to illustrate different points about recent trust fund reserve losses. Table 3 shows the states arranged according to the level of their 1989 reserve ratio multiples. During 1991 and 1992 four states borrowed from the FUA trust fund; Michigan, Connecticut, the District of Columbia and Massachusetts. Ranking the 1989 state reserve ratio multiples in ascending (reverse) order as in Table 3, these states ranked 1, 2, 5 and 8 respectively. The three other states needing loans in the first four months of this year (Missouri, New York and Maine) ranked 10, 21 and 29 respectively in

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[10] The concentration of reserve losses among a few big states is not unique to the 1990-1992 downturn. During the recession of the early 1980s four large industrial states (Illinois, Michigan, Ohio and Pennsylvania) accounted for about 80 percent of total borrowing.

Table 3. Thus the need for loans while related to initial reserve balances has other determinants as well.[11]

One informative way to examine the loss of reserves during 1990-1992 is to note changes in unemployment rates by state. Table 3A rearranges the information from Table 3 to emphasize recession-related increases in state unemployment. The largest proportional increase in state-level unemployment occurred in New Hampshire where the 1990-1992 average rate was 6.80 percent, the 1987-1989 average was 2.83 percent yielding a ratio of 2.400. States are arrayed in Table 3A according to their unemployment rate ratios.

A striking feature of Table 3A is the geographic concentration of the increases in unemployment. As noted, the national average increase for 1990-1992 relative to 1987-1989 was 15.6 percent or a ratio of 1.156. There are sixteen states whose ratios of unemployment rate ratios exceed the national average. Fifteen of the sixteen are located along the eastern seaboard of the U.S., and the sixteenth is California.[12]

The most dramatic increases in unemployment occurred in New England whose constituent states occupy the five top rows and the eighth row in Table 3A. All three Middle Atlantic states had above-average increases, New York and New Jersey more so than Pennsylvania. Of the states in the South Atlantic division, six also experienced above-average increases while a seventh (South Carolina) roughly matched the national average. Thus Georgia was the only Atlantic coast state not to experience a major increase in

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[11] A partial list would include: i) state legislative actions to improve solvency, ii) automatic changes in taxes and benefit payments activated by reductions in trust fund balances and iii) the size and persistence of the increase in unemployment (a proxy for the depth of the recession in the state).

[12] The recession might be characterized as bicoastal simply because California is so large relative to other states on the West coast. Note in Table 3A that for the other four states in the Pacific division the ratio of unemployment rates ranges from low to high as follows: Washington - .937, Alaska - 1.005, Hawaii - 1.058 and Oregon - 1.070. None of these four states had its unemployment rate ratio increase by even half of the national average increase.

unemployment during 1990-1992.

Note also in Table 3A that nineteen states actually had lower average unemployment rates during 1990-1992 than in 1987-1989. An additional twelve states with higher unemployment during 1990-1992 experienced increases that were less than half the national average increase, i.e., their ratios lie between 1.000 and 1.078. Thus for 31 of 51 states, unemployment rates either declined during 1990-1992 or increased only moderately. This "fact" provides much of the explanation for the limited borrowing by state UI programs during the current downturn.

Yet another perspective on trust fund reserve adequacy and reserve losses in the recession is provided in Table 3B. Here the state-level information from Tables 3 and 3A has been rearranged to focus on reductions in reserve ratio multiples between 1989 and 1992. Maine leads the nation with a reduction in its multiple of .78. The multiples in twelve states decreased by .40 or more, and of these nine are located along the Atlantic coast.[13] As with the increases in unemployment the decreases in reserves have been concentrated mainly along the eastern seaboard.

The data in Table 3B are also useful for showing the full range of reductions in reserve ratio multiples during 1990-1992. First, however, two caveats. Large draws on UI trust fund will certainly continue through 1993 and perhaps longer (further lowering the multiples) if the economic recovery falters. Also, because the present recession is comparatively mild, larger reductions in the multiples would take place in a more serious downturn. Keeping these qualifications in mind note the range of reductions in the reserve ratio multiples. None reached -1.0 and only five equaled or exceeded -.60. The five states at the top of Table 3B are particularly relevant because each state experienced a major increase in unemployment. The lowest unemployment rate ratio within this set of five is New York's 1.476.

To help place the 1990-1992 downturn into a longer term

[13] The other three are California, Missouri and Nevada.

perspective, Table 4 displays state-level summary information for the four most recent recessions. The top half of the table focuses on increases in unemployment while the bottom half summarizes reductions in reserve ratio multiples.

The most important inference to be drawn from Table 4 is straightforward and simple. The 1990-1992 downturn is mild relative to the previous three downturns. Consider first the increases in state unemployment rates. The numbers of states (out of 51) with ratios of 1.25 or larger were as follows: 1971-1973 - 37, 1974-1976 - 30, 1981-1983 - 42 and 1990-1992 - 16. Both summary measures at the end of each line (the State Median and the U.S. Total) convey the same message: the 1990-1992 downturn was comparatively mild in terms of the increase in the average unemployment rate.

Turning to the reductions in reserve ratio multiples summarized at the bottom of Table 4, the same point emerges. The numbers of states whose multiples decreased by 0.5 or more were as follows: 1969-1973 - 34, 1973-1976 - 44, 1979-1983 - 25 and 1989-1992 - 8. Finally, the State Medians and U.S. Totals at the ends of these four bottom lines reemphasize the small reductions in reserve ratio multiples during 1989-1992.

From the information in Table 4 one main conclusion emerges: the increases in unemployment and losses of trust fund reserves have been unusually small during the most recent recession. Also contributing to the modest amount of state borrowing during 1990-1993 were the comparatively high levels of reserves present in many states prior to the downturn.

III. Research on Trust Fund Adequacy

This section summarizes previous work on UI trust fund adequacy and related issues. It identifies 7 areas, but there clearly are overlaps among them. The intent is to highlight what has and what has not been covered by previous research and to suggest some topics appropriate for future work. As will become apparent, some of the areas are not particularly amenable to

original research but clearly are important for future policy decisions and directions.

1. Assessing Trust Fund Adequacy

The basic question in trust fund research is: what constitutes an adequate UI trust fund? As noted in section II, the 1.5 reserve ratio multiple is the most commonly recognized solvency standard or guideline. It was first proposed more than 30 years ago, but critics view it as too conservative, i.e., it points to needlessly large trust fund accumulations. Many states have avoided solvency problems while maintaining fund balances much smaller than suggested by the 1.5 reserve multiple guideline.

The volume of previous literature on trust fund adequacy is quite limited. One literature survey completed in 1986[14] reviewed work by Bowes, Brechling and Utgoff (1980), Freiman (1980), South Carolina Employment Security Commission (1976) and Baskin and Hite (1977).

A few main conclusions from these earlier studies are as follows:

Bowes, Brechling and Utgoff (1980) - Individual states may have quite different utility functions. Hence they may try to achieve widely different target reserve balances and may exercise widely differing degrees of tax smoothing (constancy of average tax rates over the business cycle). This work does not try to assess trust fund adequacy, rather it points to explanations why observed state reserves balances (and reserve ratio multiples) would differ.

Freiman (1980) - This work was conducted with national data not state data. It pointed out the threat to solvency caused by having an indexed benefit side of UI programs, i.e., maximum benefits increase automatically with money wage rates, while the taxable wage base is fixed in nominal terms.

South Carolina Employment Security Commission (1976) - This proposes a solvency standard for required or maximum reserves. Reserves are to accumulated to a level that depends on i) the maximum duration of a recession, ii) the cost rate during this period (as a percent of total payroll) and iii) current covered

[14] See Chapter III in Barnow and Vroman (1987).

payroll.[15] They also recommend having UI tax rates be stable over the business cycle.

Baskin and Hite (1977) - They conducted a series of simulations of state-level trust fund reserves over the cyclical episodes from 1951 to 1975. Counterfactual reserve balances were imposed at the start of each recessionary episode. Four different rules were examined including the 1.5 reserve ratio multiple rule. All were found to be effective in preventing insolvency. The simulations, however, were mechanical in that the simulated flows of state-level taxes were predetermined (actual historic data) and not flows reflecting how taxes would have behaved given the reserve balances assumed at the state of each recession.

A more recent model-based analysis of fund adequacy was conducted by Vroman (1990b). The work was restricted to 7 states, but within each state a model was used that included a full representation of the state's tax statutes. Thus the response of taxes to trust fund balances and changes in trust funds was endogenous to the analysis. The 1.5 reserve ratio multiple rule was found to be generally effective, but not foolproof, in preventing insolvency. This analysis also examined the role of solvency taxes, present in 6 of the 7 states, in preventing insolvency.

Previous research has rather clearly established that if a state builds reserves to a level suggested by the 1.5 reserve ratio multiple guideline, it usually will avoid insolvency in an ensuing recession. At the same time, it is also clear that the states generally do not have UI tax statutes in place that cause their trust fund balances to automatically move towards these levels. The key research and policy question then becomes: can a lower but adequate level of trust fund reserves be identified?

It seems clear that a state's target level of reserves should recognize both past experiences in paying benefits during recessions and the size of the state's economy. Thus the research and policy question can be reformulated as: what level of the reserve ratio multiple is sufficient?

This question is directly amenable to research. By examining

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[15] These three are closely related to elements that enter reserve ratio multiple calculations.

data of the type displayed in Tables 3, 3A, 3B and 4 for various recessionary periods and undertaking more formal quantitative investigations, i.e., regression analyses, it would be possible to establish operational rules of thumb for reserve adequacy. Based on the information shown in these earlier tables, it appears that the 1.5 reserve ratio multiple guideline is too conservative for many states. However this impressionistic observation should be supported by a more rigorous quantitative analysis. Perhaps an operational guideline would be that a state should achieve a pre-recession reserve ratio multiple of at least 1.0. This issue needs to be examined.

Also, it should be kept in mind that all borrowing is not necessarily to be avoided. A state may want to pursue a strategy of maintaining only a modest pre-recession trust fund balance and then rely on automatic and/or discretionary responses (tax increases and benefit reductions) to prevent large scale borrowing. Large scale and prolonged UI trust fund indebtedness are to be avoided.

Stated in alternative terms a state may experience technical insolvency but have an adequately financed program. Occasional and/or small scale borrowing during a recession can take place without implying that a state has a financing problem. Evidence of a financing problem is repeated and large scale borrowing, long term indebtedness and failure of trust fund reserves to grow substantially during economic expansions. Chronic insolvency is less likely to arise when a state has a large trust fund and/or the ability to increase UI taxes substantially when fund balances become depleted.

2. The Response of UI Taxes to Trust Fund Drawdowns

A frequent criticism of the 1.5 reserve ratio multiple guideline is that it does not recognize the responsive of UI taxes to trust fund drawdowns. If taxes respond quickly and strongly, a state may avoid insolvency even if it enters a recession with a modest UI trust fund balance and a low reserve multiple.

Tax responsiveness operates both through regular experience rating as well as special solvency taxes which are now present in

many states. However, tax responsiveness covers several aspects that have not been examined in a systematic manner. A list of research questions would include the following.

i) Do reserve ratio and benefit ratio experience rating systems respond similarly to drawdowns in UI trust funds?[16]

ii) How large is the low-to-high progression of effective tax rates within tax schedules and across tax schedules for a given state?

iii) How much variance is there in the time lag between a trust fund drawdown and the response (increase) in effective tax rates (through moving to a higher tax schedule and/or implementing a higher solvency tax)?

iv) Many states set tax rates using array allocations of employers.[17] How much does the use of array allocations improve the predictability of tax yields?

v) Does indexation of the taxable wage base (or more generally symmetrical treatment of indexation on the tax and benefit sides of UI programs) improve long run solvency of state UI programs?

vi) How effective are the flexible financing features currently present in the UI programs of Illinois, Pennsylvania and several other states?[18]

vii) To the extent that a state consciously implements increased

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[16] Brechling and Cook have initiated some work on this topic but to date it has been highly stylized and has omitted key features such as the presence of solvency taxes and multiple tax schedules in benefit ratio jurisdictions.

[17] Employers are arrayed from low to high on a measure of experience. Their taxable wages are then used to make a wage distribution, and ascending tax rates are set along predetermined ranges of the associated cumulative wage distribution.

[18] This question has received some attention in Vroman (1990b) and more explicitly in Worden and Vroman (1991a). The latter paper focused on the flexible financing features in Illinois and Pennsylvania. Two conclusions of note were the following. First, flexible financing was more effective at countering the effects of small downturns as opposed to large ones. Second, what was termed a flexible financing package enacted in Illinois actually achieved most of its improved long run solvency prospects through benefit reductions and tax increases that were invariant to the level of the trust fund. Flexible financing in this instance was to a large degree a misnomer.

flexibility in its UI financing, how much does this weaken the performance of UI as an automatic stabilizer of economic activity? A model-based assessment of the automatic or built-in stabilizing performance of UI would be useful.

3. Pooling UI Trust Fund Reserves

This is not a priority research area per se, but it is important to include in a thorough analysis of UI financing. Policy proposals to share reserves across UI programs were made in the 1970s. Specific proposals were termed cost reinsurance and cost equalization. Discussions of the earlier proposals are given in Becker (1980) and Crosslin (1980). Even though proposals of this type have not surfaced recently, their logic is appealing.

At present the individual states are fully responsible for financing their own programs. Strong evidence has now accumulated that regional labor markets can deviate from the overall national labor market for extended periods of time.[19] Table 3A helps illustrate this point with data from the most recent recession. The range of unemployment rate ratios was from New Hampshire's 2.400 to Nebraska's .671 while the national ratio was 1.156. Given this "fact" of geographic diversity, it might be reasonable to create explicit interstate arrangements for sharing UI trust fund reserves. If reserves from states in prosperous regions could be a source for loans to trust funds in regions with high unemployment, the UI system as a whole could function with fewer total reserves.

As noted, this area should be viewed primarily as a policy area not as an area for additional research. The answers to questions such as: how much and for how long do state economies deviate from the national average, however, would be relevant for the design a proposal to share UI reserves across regions.

4. The Link Between UI Trust Fund Levels and UI Benefits

There are at least two questions here. First, the decline in UI claims of the early 1980s is to some extent linked to problems

[19] See for example Blanchard and Katz (1992) and Vroman, Worden and Acs (1992).

of trust fund inadequacy. The work of Corson and Nicholson (1988) points to the importance of changes in UI laws in the states in causing the IU/TU ratio to decline. Ongoing PhD dissertation work by Baldwin points to a similar conclusion. Earlier work by Vroman (1986) provided details of the cutbacks in benefit availability in the early 1980s in states with the largest financing problems. More work on this question could be instructive, but it probably should be undertaken within the context of research focused on benefit availability. Since the current paper is focused on UI financing, no more comments on the reduced receipt of UI benefits during the 1980s will be made here.

There is, however, a second linkage between trust funds and UI benefits that should be examined. Policy makers in the states interested in raising UI trust fund balances frequently must contend with the following argument. It is difficult or impossible to permanently raise the level of the trust fund because large trust funds invite raids through various forms of benefit liberalizations. Large trust fund balances encourage increases in the weekly benefit maximum, easing monetary eligibility requirements and other liberalizations.

The preceding argument is often used by employer representatives opposed to tax increases designed to increase trust fund balances. This asserted linkage between trust fund adequacy and benefit availability has never been subjected to empirical analysis. The test is not particularly complicated. The dependent variable would be a 0-1 dummy (equal to 1 for a benefit liberalization) while the independent variable of interest would be a measure of trust fund adequacy, e.g., either the level or change in the reserve ratio multiple. Testing could be carried out with pooled state-year data. The work should be undertaken to provide evidence on the assertion that large trust funds invite raids. It could be done without a large expenditure of resources.

5. UI Taxes, Labor Inputs and Plant Location

Proposals to improve the solvency of state UI programs frequently involve increases in UI taxes. Because UI taxes are an

element of labor costs, employer decisions about the mix of labor inputs and/or plant location decisions could be affected. Increased UI taxes cause cost differentials to arise or widen.[20]

The current federal taxable wage base of $7,000 per covered worker provides employers with incentives to utilize high paid labor. This may contribute to higher unemployment among low wage workers. There are also uneven effects of the tax base across industries as some industries utilize low wage and part time workers to a much greater extent than others. This aspect of labor-labor substitution has been examined in earlier research. Hamermesh (1993) provides a recent survey. A byproduct of increasing the federal taxable wage base would be to reduce employer disincentives against using low wage workers.

On average UI taxes represent about .8 percent of labor costs for covered employers. However, average effective employer tax rates vary widely across states. In 1991, for example, employer UI taxes as a percent of payroll ranged from .27 percent in Virginia to 2.10 percent in Alaska.[21] The effects of costs on plant location decisions have been investigated with recent work done by Bartik (1991) at the Upjohn Institute. Plant location decisions are also affected by interstate differences in the costs of workers's compensation, health insurance and private pensions as well as UI taxes. These other programs are a larger share of labor costs than UI taxes. Even larger interstate differentials in wage rates exist.

Evidence of the effects of these costs on plant location suggests some effect but quite modest in size. The effect may operate as much through a perception of "business climate" in states as through detailed comparisons cost differences for

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[20] It is necessary to assume the UI tax is not fully passed backward onto money wage rates. Under full backward shifting employer labor costs would not increase because of an offsetting slowdown in money wage growth.

[21] The effective tax rate was even higher (2.61 percent) in Puerto Rico.

individual programs such as UI or wage differentials. The presence or absence of a right to work law, for example, may play as large a role in the perception of business climate as detailed cost comparisons.[22] High UI taxes per se may reduce employment by something approaching 0.5 percent.[23] Evidence from past studies, e.g., Chapter 2 in Bartik (1991), is probably adequate for judging the size of these effects.

6. Encouraging Improved Solvency in the States

Since states with low reserves are most likely to need loans from the FUA trust fund, alternative ways to encourage fund building by such states should be explored. Two broad approaches that might be considered are i) to mandate quantitative standards for fund balances and ii) to provide financial incentives for fund building. An analysis of ways to encourage fund building could be instructive. This is not so much a research area as an area of obvious policy importance.

Financial incentives could take a number of forms. i) There could be interest rate rewards to states whose reserves meet a minimum threshold level. To limit the costs to the U.S. Treasury, the increment to the interest rate could be restricted to balances over certain ranges, e.g., for reserves over the range of reserve ratio multiples of from 0.5 to 1.0. ii) Rewards could also take the form of easier borrowing conditions for insolvent states that had satisfied a specific trust fund solvency standard prior to the onset of a recession.

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[22] Making cost comparisons across states involves a number of difficulties. The most important factors are interstate differences in wage levels and labor productivity. Wage differences loom much larger in interstate cost comparisons than fringe benefit costs. Gauging productivity differences is especially difficult.

[23] This back of the envelope estimate assumes UI taxes raise labor costs by 1.0 percent above the national average and that the elasticity of demand for labor is -0.5. Both assumptions are "high end" orders of magnitude. Of course, even larger estimates could be derived if all fringe benefits and money wage differentials were included in the calculations.

7. Alternative Uses of UI Trust Funds

Several emerging public policy considerations are causing interest in the alternative uses of UI trust funds to grow. i) It is increasingly recognized that UI programs should be structured to encourage reemployment as well as to provide income maintenance. ii) Ongoing technological change will make worker training more of a continuing activity throughout one's working life rather than an activity appropriate mainly for younger workers and new employees. iii) Public budgets are increasingly under strain, hence less capable of supporting new policy initiatives. iv) The aggregate assets of UI trust funds are substantial.

For states with "large" balances, consideration might be given to providing rewards for prudent behavior, e.g., permitting such states to use a portion of their trust fund balances for positive adjustment activities as well as paying UI benefits. One proposal would be the following: grant a state freedom to use all reserves that exceed a threshold level specified in a federal solvency guideline. Permissible alternative uses might be restricted to labor market assistance and human capital acquisition such as formal education, training, mobility assistance and job search assistance. Interest in using UI trust funds to finance such activities seems likely to grow.

Developing a federal guideline for trust fund adequacy would provide useful information for discussions of alternative uses of trust funds. Clearly a state having difficulty financing its regular UI program should not undertake a new set of activities to be financed through its UI trust fund (unless enhanced funding is provided at the same time). However, states with substantial trust fund balances should be able to use those balances in more ways than just the payment of UI benefits. Developing a measure of trust fund adequacy and authorizing "alternative uses" for states satisfying such a measure would help some states to finance positive adjustment activities without resorting to new taxes.

Before advocating or enacting enabling legislation to permit alternative uses of UI trust funds, there are important questions

to be addressed. The geographic areas where alternative uses might be in greatest demand and where the alternative uses might confer the largest benefits could be the areas of highest unemployment. If this is the case, the UI trust funds in those areas would already be under strong financial pressures just to sustain UI benefit payments. Thus there may be a better case for financing alternative uses through a national financing mechanism. Questions like this need to be recognized and addressed before enacting a proposal to authorize alternative uses of UI trust funds.

One form of alternative uses is already coming to pass through the creation of state reserve funds. These funds are created by diversion of some employer UI taxes from the state's federal UI trust fund account into a state-administered account.[24] The principal in the state reserve fund remains dedicated to paying UI benefits. However, interest earnings from the state reserve fund is then used to finance activities such as training, enhanced UI administration and increased ES adjustment services. State reserve funds are now present in North Carolina, Idaho and Oregon.[25]

Another way to implement alternative uses UI funds is to lower employer UI taxes, create a state payroll tax equal in size to the UI tax reduction and use all the proceeds of the new state tax for positive adjustment activities. This was pioneered by California when it created the Employment Training Panel (ETP) in 1982. Several other states have followed California's lead. This arrangement could pose a larger threat to UI trust fund solvency than the creation of a state reserve fund because all of the diversion is put to alternative uses (as opposed to just the

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[24] The term diversion perhaps may seem strong but it is accurate. States with reserve funds have lowered taxes paid into the federal UI trust fund while enacting a state tax to be paid into a state-administered fund. It is not a coincidence that the dollar amounts of the two tax streams are identical.

[25] One analysis of state reserve funds is found in Worden and Vroman (1991b).

interest earnings).[26] Because these state-level initiatives are comparatively new, there has not been a systematic analysis of their threat to UI trust fund solvency.

The preceding areas are clearly not all of equal importance. Without attempting to present much of a justification, it seems to this author that the first two are of greatest importance. There is a clear need to develop a solvency standard to help the states assess the adequacy of their trust fund reserves. There is also a need to develop a better understanding of tax responsiveness in order assess the solvency prospects of states whose current trust fund balances are low when assessed on a standard measure like a reserve ratio multiple. Improved understanding of trust fund solvency requirements and tax responsiveness would inform the policy issues identified above.

IV. Experience Rating

Regular state UI programs are financed mainly by payroll taxes on covered employers.[27] Employer taxes are experience rated, i.e., benefit payments to former employees and employees on temporary layoff affect the UI taxes paid by each employer. The details of employer tax rate setting are determined by individual state UI programs within a framework specified by federal UI legislation.[28] A federal payroll tax of 6.2 percent of taxable wages is reduced to

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[26] The threat to UI trust fund solvency posed by the two types of diversions is directly related to their relative sizes. The comparison here is between the scale of interest earnings from state reserve funds relative to the direct tax diversion in a program like California's ETP.

[27] Some states also tax covered employees,e.g., Alaska, New Jersey and Pennsylvania in 1993.

[28] Two main requirements on the states are that i) the state's taxable wage base be at least as high as the federal tax base (currently the first $7,000 of annual earnings for each covered worker) and ii) that the maximum state UI tax rate be at least 5.4 percent of taxable payrolls.

0.8 percent in states deemed to have acceptable experience rating systems. Currently all 53 state UI programs practice some form of experience rating.

There are two main methods for measuring employer experiences. Stock-based experience rating systems take account of all past benefits and taxes as reflected in individual employer trust fund account balances. The account balance on a specific computation date (often June 30th and measured as a percent of taxable or total covered wages, i.e., as a reserve ratio) partially determines the tax rate to be paid during the next tax year. Reserve ratio experience rating is used in 33 UI programs.

Flow-based experience rating uses a measure benefit payments (either benefits or a close proxy such as benefit wages, i.e., the base period wages of claimants) over a specified period as an indicator of experience. The most common flow-based system uses three year benefit ratios, i.e., benefit payments relative to taxable or total covered wages over the past three years, as a main determinant of individual employer tax rates. There are 20 flow-based experience rating systems.[29]

Both types of experience rating systems utilize tax schedules that specify a minimum, a maximum and a set of intermediate tax rates to link employer experience indicators to their tax payments. Most state UI tax statutes specify several tax rate schedules, not a single schedule, as potentially applicable in a given year. For a given measure of experience, schedules with successively higher rates are activated as the aggregate trust fund balance declines to successively lower levels. Thus, average employer tax rates rise

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[29] Seventeen states use benefit ratios while two use benefit wage ratios and one uses payroll declines as flow-based measures of experience. The payroll decline system in Alaska uses the decrease in covered payrolls as a proxy for the covered wages of workers on layoff. Included among the seventeen benefit ratio states are Michigan and Pennsylvania which use both benefit ratios and reserve ratios to set employer tax rates. Thus the counts of stock-based versus flow-based systems could be either 33-20 or 35-18 depending on the classification of Michigan and Pennsylvania.

following an economic downturn because individual employers show worse experience (lower reserve ratios or higher benefit ratios) and because higher tax rate schedules are activated.

All states constrain potential employer UI tax liabilities by specifying minimum and maximum tax rates for a given year. The presence of minimums and maximums also limits the degree of experience rating. Full experience rating would be present if an extra $1 of benefit payments eventually caused the employer's UI tax to increase by $1. Since the response of UI taxes to increased benefit payments operates with a lag, an appropriate measure of the degree of experience rating involves comparisons of current benefits with future taxes. In later paragraphs the issue of measuring the degree of experience rating will be examined.

In practice, the differences between stock-based and flow-based experience rating systems are smaller than suggested by the preceding description. Most of the flow-based systems have several tax schedules, and the trust fund balance on the computation date determines which schedule is used in the next tax year. Also, most states now provide for so called solvency taxes that partially determine annual employer tax payments. Typically the solvency tax is levied at a flat rate and is activated when the state's UI trust fund as of the computation date falls below a predetermined threshold.[30] Multiple tax rate schedules and solvency taxes are especially important for flow-based systems because they in effect mean the state uses a stock measure (the trust fund balance) as well as a flow measure (the benefit ratio) to set individual employer tax rates. Their presence helps to ensure that UI trust fund balances are restored following recession-related drawdowns.

Each year a substantial fraction of UI benefit payments are not assigned as the responsibility of individual active employers. Three types of benefit payments fall outside the scope of experience rating: noncharged benefits, ineffectively charged

[30] There may be a series of increasing solvency tax rates associated with successively lower UI trust fund balances.

benefits and benefits charged to inactive employers. Each of the three will be briefly described.

Noncharged benefits originate from payments to former workers in cases where the employer did not cause the job termination. For example, if a worker quits to take what is perceived to be a better job but then is laid off or the new job is eliminated, the individual may successfully claim benefits. A substantial fraction of the worker's base period earnings would be with the former employer (where the worker had quit). However because the first employer did not initiate the earlier job termination, there would be no charging to that employer's account. Noncharges are the general responsibility of the UI tax system not of individual employers.

Ineffectively charged benefits arise when the employer's experience measure (either a reserve ratio or a benefit ratio) does not generate tax revenues equal to the benefit charges assigned to the employer's account. That account may be taxed at the maximum tax rate, but benefit charges may be substantially larger. Although an ineffective charge for the current year could be recovered in a later year, in practice many ineffective charges are never recovered, and certain employers taxed at the maximum rate continue to incur benefit charges far in excess of their tax payments.[31] Raising maximum tax rates reduces the volume of ineffective charges. In contrast to noncharges, ineffective charges are assigned to individual employer accounts, but the implied taxes are not recovered because of the maximum tax rate.

A separate category of ineffective charges are charges to

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[31] The computations leading to ineffective charges differ in stock-based and flow-based experience rating systems. They are simpler in flow-based systems because of their shorter memory. Stock-based systems can retain information on ineffective charges for longer periods hence have greater potential for recovering these charges from the employer at a later date. In practice, allowing employers to "write off" ineffective charges when computed reserve ratios reach very large negative levels, limits the ability to recover ineffective charges in reserve ratio states.

inactive employer accounts. Although the employer is no longer active, benefits continue to be paid to former employees. In reserve ratio states the associated account may initially have a positive balance to defray some of these charges, but typically the accounts are exhausted long before benefit charges cease, leaving active employers with the associated liabilities.

Noncharges plus the two types of ineffective charges can amount to as much as half of total benefit payments in a few states. The primary function served by the minimum tax rate is to generate revenues to cover the costs of these charges.

Since 1988 the UI Service of the U.S. Department of Labor has required states to report benefit payment summaries that separately identify these three types of charges and their combined size as a fraction of total benefit payments. The summary statistic is termed the Experience Rating Index (ERI). It is computed by summing noncharges, charges against inactive accounts and an estimate of ineffective charges (all for the current year), subtracting the total from total benefit payments and dividing the difference by total benefit payments. By construction, the ERI is a proportion which can range from zero to unity with higher values indicating a higher degree of experience rating.

Before discussing the ERI further it will be useful to first consider what is meant by perfect experience rating. Experience rating is inherently a dynamic concept. It should compare the size of benefit charges against individual employer accounts with the taxes that the benefit charges cause the employer to pay. Perfect experience rating would be present if each extra dollar of benefit payments caused the employer to pay one dollar of increased taxes. Since experience is the basis for employer taxes, tax payments take place after the payment of benefits. Thus it is necessary to compare flows from different time periods, i.e., to compare the present value of the added future taxes with current benefit payments. In many states the combined effects of noncharges, charges against inactive accounts and ineffective charges cause the degree of experience rating to depart substantially from full

experience rating.

There is a serious gap between the concept of experience rating and the measurements underlying the ERI. There are two flaws in the ERI as currently measured. First, in both stock-based and flow-based systems, the estimate of ineffective charges is based solely on current year information, i.e., employers are grouped by tax rate and ineffective charges are measured as the difference between benefit payments and taxes for those tax rate categories were benefits exceed taxes. There is no recognition of taxes to be paid in later years due to benefits charged this year. On average, this procedure overestimates ineffective charges (at least for employers in tax rate categories where current benefit charges exceed tax payments).[32]

Second, all charges against inactive accounts are counted as ineffective charges. This is accurate for flow-based systems because no current taxes are paid by such employers. However, in stock-based systems there is no recognition of drawdowns of existing account balances which cover some part of the charges against these accounts. Thus in a given year, ineffective charges against inactive accounts are overestimated to the extent these accounts have positive balances when the firms cease operations.

Both flaws can be partially remedied by averaging data from several consecutive years. To date no analysis has been undertaken to assess how many years should be averaged or to examine the effects of multiyear averaging on state-level ERIs. This analysis could be undertaken for most states for the five years 1988 to 1992. A new analysis of ERIs as currently computed should also review the issue of how to best measure ineffective charges.

One clear pattern in the current measures of experience rating

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[32] The overestimate for these employers who tend to be in the higher tax rate categories is to some extent offset by the excess of taxes over benefits for employers in other tax rate categories. The net effect across all employers will tend to cancel out in measures that cover several years. For at least the initial years of economic downturns, however, ineffective charges are overstated.

is that the ERIs have a strong cyclical component arising mainly from the method of measuring ineffective charges.[33] Table 5 shows state-level ERIs for rating years 1988 to 1992. Many ERIs declined between 1990 and 1991 and even more between 1991 and 1992, particularly among states located along the Atlantic coast. Of the fifty averages shown in Table 5 only three fall below 0.50 and only two are 0.80 or higher. For 24 states 30 to 40 percent of all benefit charges over the 1988-1992 period were noncharges, ineffective charges or charges against inactive accounts, e.g., the average ERI lies in the range from 0.60 to 0.70.

The summaries in the bottom two lines of data show the national average ERI was highest in 1989 and lowest in 1992. Both five-year averages indicate that more than one third of benefits are not effectively charged to the accounts of active employers. Between 1990 and 1992 the national average ERI decreased by 10 full percentage points from 66 to 56 and state ERIs declined in 39 jurisdictions. The cyclical pattern of UI benefit payments has a clear effect on the ERIs for single calendar years.

V. Research on Experience Rating

This section discusses 6 areas of research that have received widely differing amounts of attention in the past. In some areas previous research has reached differing conclusions. As in section III, the intention here is not to provide an extensive literature review, but rather to provide an introduction to previous work and note areas not researched and areas where differing conclusions have been reached.

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[33] In the first year of a downturn benefit payments rise sharply so that benefit payments for several tax rate categories exceed current year tax receipts. Under present measurement procedures, the estimate of ineffective charges (current year benefit charges less taxes) rises sharply in both stock-based and flow-based systems. In later years measured ineffective charges decline both because employers move to higher tax rate categories and because benefit charges decrease.

1. Conceptual Issues in Experience Rating

The intuitive concept of experience rating, that increases in benefit charges against an employer causes the employer's UI taxes to increase, is straightforward. However, questions can be raised as to the meaning of the terms "perfect experience rating" and "the degree of experience rating." Also, most persons would agree that some charges should not and/or cannot be assigned to individual employers, either because they were not responsible for the unemployment or because they have ceased operations. Thus there is an issue regarding the meaning of the term the "optimal" degree of experience rating, i.e., the extent of the downward deviation from full or 100 percent experience rating.

General discussions of experience rating are given in Chapter 17 of Haber and Murray (1966) and Chapter 1 of Becker (1972). A basic question about experience rating is the degree to which employers are responsible for occurrences of unemployment. Clearly several other factors also cause new spells of unemployment, e.g., job search decisions by workers, public policies and technological change. To the extent the latter are responsible factors, it implies the optimal degree of experience rating should be considerably less than 100 percent. There also can be issues of rating industries versus individual employers in industries like construction where worker turnover is frequent but mobility typically involves moves within the same industry. Finally, since the benefit payments occur prior to the assignment of tax obligations there are present value issues, i.e., discounting future tax receipts, associated with measuring the degree of experience rating.

The preceding identifies some of the issues present in a study of experience rating. A good essay covering the main conceptual issues might be helpful to the ACUC as background for its deliberations. Recent research on imperfect experience rating and its effects in causing unemployment occurrences has tended to assume that the meaning of experience rating is obvious, that more experience rating is better than less and that measuring the degree

of experience rating is straightforward.

2. Measuring Experience Rating

Several past studies have undertaken measures of experience rating usually for one of two purposes: i) to assess the degree of cross-subsidization of industries or ii) to assess the effects of imperfect experience rating in causing "excess" layoffs by employers. Since these two research areas will be separately discussed in the present survey, little will be said of them here.

The most systematic attempt to measure experience rating is the ongoing effort undertaken by the UI Service with cooperation from the individual state UI agencies. As noted in section IV the experience rating index (ERI) has been measured for individual states since 1988. The elements that enter the calculation of the ERI are taken from a standardized reporting form[34] where all the data on benefits and taxes refer to a single tax year.

Some limitations of the ERI were previously noted in section IV. i) To most appropriately match the taxes associated with current benefits it would be necessary to gauge the future taxes (as opposed to taxes for the current year) to be paid as a result of current benefit payments. This presents very difficult measurement problems. If the measurements are not attempted, however, there is no way to assess the errors, say, in the estimates of ineffective charges against active employers as currently measured in the ERI. ii) All charges against inactive employers are treated as uncollectible. It would be important in a reserve ratio state to measure the share of these charged benefits which in fact are covered by existing account balances.

In both of the preceding areas it would be desirable to conduct an in-depth study of a stock-based and a flow-based system. From such a study one could assess how much the current measurement of the degree of experience rating as reflected in the ERI departs

[34] Reporting is recorded on ETA Report No 204, The Experience Rating Report. Summaries of state ERIs based on the 204 Reports are periodically issued by the UI Service as field memoranda.

from a measurement which is more conceptually correct. The treatment of new employers might also be included in the study to identify possible problems arising from their current treatment.

It seems clear that applying the current methodology to measure the ERI would produce larger errors at the micro level than for an entire state. As noted state-level errors might be substantially reduced by averaging ERIs over several years. These questions also might be included in a study that reviews the ERI.

3. The Determinants of the Degree of Experience Rating

Despite the limitations suggested above, the ERI as currently measured represents the only systematic and repeated attempt to assess the degree of experience rating. As such, it should be subjected to quantitative analysis.

A pooled state-year analysis could be undertaken for the 1988-1992 period using as many observations as appropriate.[35] The dependent variables would be the overall ERI and the three types of benefit charges that cause departures from full experience rating. Explanatory variables would include the following: the minimum statutory tax rate, the maximum statutory tax rate, a business cycle indicator, an indicator of state benefit payout rates (benefits as a percent of payroll), the tax base (measured relative to average worker earnings), type of experience rating system (stock-based or flow-based) and indicators of state laws and practices affecting noncharges and ineffective charges (writeoffs in reserve ratio systems).[36]

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[35] The hard copy printouts of ERI data suggest discontinuities in the data from a given state for adjacent years. At the start of the analysis, the state-year observations for each element of the ERI should be carefully reviewed and follow-up with the states should be undertaken. An example of an apparent data anomaly is that Illinois reported zero statewide noncharges for 1988, 1989 and 1990. The explanation may be related to a change in the state's method for assessing experience, but it should be explored.

[36] The list is offered as suggestive. A more detailed derivation of hypotheses leading to choice of explanatory variables would, of course, be appropriate in the actual study.

As a first analysis of data whose accuracy can be questioned, the study would face potentially serious criticisms. Since making both cross section and time series comparisons of state-level ERIs can provoke questions, more than the usual number of caveats would be appropriate. However there could be gains either from new insights or from improved parameterizations of facts already generally known.

4. Interindustry Cross-subsidies under Current Experience Rating

This is an old area of research starting with Becker (1972). It has also been investigated by Munts and Asher (1980). Both of these studies operated with industry data. More recently there was a careful analysis by Geraci and McPherson (1992) conducted for the Texas Employment Commission and covering the years 1978 to 1987. The most comprehensive recent work has been done by Anderson and Meyer (1992). They examined the patterns of interindustry subsidies for 22 states over 10-12 year periods, often 1980-1991, as well as intraindustry subsidies in Georgia and Washington. Both of the recent studies have utilized micro data.

Before undertaking any new work on interindustry cross subsidies, a careful review of these earlier efforts would be appropriate. We know generally that the construction industry is the recipient of the largest net subsidy, i.e., benefit charges exceed employer taxes by the widest margin. Agriculture, mining and many manufacturing industries also often receive large net subsidies. Conversely, industries with low numbers of UI beneficiaries such as retail trade, finance and many service industries often finance the net subsidies to construction and the other "winners." One earlier literature review was done by Vroman (1989). New work on interindustry cross-subsidies probably is not a high priority.

One intriguing finding in the work of Anderson and Meyer (1992) is the size of the cross-subsidies within industries. Working with micro data from Georgia and Washington they found the groupings of winners and losers within industries also were quite stable. This finding probably does warrant follow-up research to

determine the persistence of intraindustry patterns. If their findings are confirmed, there are larger cross-subsidies than suggested by work that disaggregates only to the level of industry divisions or two digit industries.

One other subject that has not been explored is how cross subsidies to industries differ according to the three factors: noncharges, ineffective charges and charges against inactive accounts. If one were to propose policies such as raising the maximum tax rate in a state it might be useful to know how much this factor alone would reduce ineffective charges. Before considering any new data collection, however, analysis of data associated with current ERI reporting should be undertaken.[37]

5. Imperfect Experience Rating and Unemployment Occurrences

This is a comparatively new area of research first stimulated by Feldstein (1975). The general thrust of this work is to show that imperfect experience rating, specifically employers taxed at the maximum rate, causes excessive layoffs. The workers typically are subject to recall and do not search for other jobs. Thus a second avenue whereby UI "causes" increased unemployment is the result.[38]

This literature has often concluded that a substantial element of observed unemployment is due to imperfect experience rating. Feldstein's early work suggested an increase in the TUR of something like 0.70 to 1.25 percentage points. Topel (1985) derived even larger estimates, an increase at least 1.6 percentage points with most of the effect due to imperfect experience rating. In his data the underlying unemployment rate was 5.16 percent. Topel's work indicates imperfect experience rating is responsible for about

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[37] See for example the analysis of ineffective charges in Maryland in Vroman (1990a), Tables 6 and 7 and associated text. This used the ETA 204 data for rating year 1989 to estimate the reduction in ineffective charges associated with raising the maximum tax rate of 5.4 percent incrementally up to 7.5 percent.

[38] The traditional avenue is that payment of unemployment benefits prolongs unemployment duration.

30 percent of layoff unemployment and 20 percent of overall unemployment.

This analysis points to a comparatively painless route to make a substantial reduction in unemployment, i.e., increase the degree of experience rating. Raise the maximum UI tax rate and temporary layoffs will fall is the message of this research.

I feel the estimates of added unemployment from this research are much too high. As a hypothesis with important policy implications, however, additional testing represents the scientific way to proceed. There is now a way to judge the degree of experience rating in individual states, i.e., the ERI. If ERIs are roughly accurate, one testable implication is that temporary layoffs should be much more prevalent in states with low ERIs than in states with high ERIs. Also, the experience rating measures from these earlier studies should be compared with the ERIs. The researchers in this area have never had their measures of the degree of experience rating subjected to outside controls as would be the case using the ERI. Thus more work on this topic would be an important undertaking.

To the extent that interindustry patterns of cross-subsidies are persistent, there is also a question of interindustry resource misallocations and associated deadweight losses. Employment in industries like construction increases to some extent while in industries like retail trade it is reduced. Topel (1990) and Anderson and Meyer (1992) have examined this issue. The size of the estimated effects are small, and much of the distortion is associated with the implied expansion of construction industry employment. To the extent that the UI tax is shifted backward, however, the distortions would be smaller than estimated.[39]

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[39] One of the conditions that makes backward shifting of payroll taxes more likely is a perceived valuation of program benefit payments by workers. Recidivism in the UI benefit status of construction workers is known to be widespread. Thus it seems likely that substantial backward shifting of the tax onto money wages does occur in construction.

6. Experience Rating and Controversion of UI Claims

The U.S. is unique among advanced industrialized economies in the low fraction of its unemployed who claim and receive UI program benefits. The program is also characterized by an unusually high degree of controversion over UI claims. Roughly 30 percent of administrative resources devoted to paying UI benefits are absorbed in administrative processes that decide nonmonetary issues and appeals. It is often asserted by labor representatives that a major reason for both the low claims rate and high rate of controversion is experience rating. Stated simply, employers have financial incentives to contest UI claims, i.e., to reduce their UI taxes.

This subject has not received serious research attention. The explanation for high degree of controversion and its consequences for UI recipiency should be studied. One possible analysis would be to use states as units of observation and test whether measures of controversion have significant effects on the IU/TU ratio. Because of the absence of previous research, it probably would be useful for the ACUC to cast a wide net initially to determine the types of analyses that might be feasible and/or persuasive.

Selecting priorities from among the preceding 6 areas is somewhat difficult. I feel areas 1, 2, 5 and 6 are all important. Perhaps the ACUC should consider small ventures, e.g., literature reviews and thought pieces, before committing substantial resources to any one of the preceding areas.

VI. Conclusion

This report is already lengthy and may cover more details than are necessary. The most important conclusion to this author is the following. More than fifty years after the founding of unemployment insurance with its method of trust fund financing, the program still does not have a commonly recognized standard for assessing the adequacy of state trust funds. I feel the Advisory Council on Unemployment Compensation should make the development of a solvency standard one of its top priorities.

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Table 1. Federal UI Trust Fund Balances, 1988-1992.

Year	Federal UI Trust Funds: End of Year Balances			
	ESAA	EUCA	FUA	TOTAL
1988	895	4707	2540	8142
1989	626	6036	1504	8166
1990	1114	7414	3702	12230
1991	1243	7146	5787	14176
1992	1241	72	3720	5033
	Statutory Limit at the End of FY 1993 - a			
	1200	8500	14200	23900

Source: Trust fund reports from the U.S. Department of the Treasury. All data measured in millions of dollars.

a - Limits for the individual trust funds computed as follows: ESAA - 40 percent of combined monies for UI administrative grants plus ES allotments; EUCA - 0.375 percent of covered payrolls; FUA - 0.625 percent of covered payrolls. Different limits will apply in FY 1994.

Table 2. State UI Trust Fund Reserves and Borrowing

End of Year	Reserve Ratio Multiples - Number of States							National Reserve Ratio Multiple
	Negative	0.0 - 0.499	0.5 - 0.999	1.0 - 1.499	1.5 - 1.999	2.0 and Higher	Total	
1969	0	0	1	16	15	20	52	1.68
1973	1	4	14	12	12	9	52	1.04
1979	9	13	16	12	2	0	52	0.41
1989	0	9	22	18	3	0	52	0.85
State Borrowing Activities 1974-1979								
Initial RRMs	1	4	14	12	12	9	52	
States with Loans	1	4	12	5	2	0	24	
States with "Large" Loans	1	4	8	1	1	0	15	
State Borrowing Activities 1980-1987								
Initial RRMs	9	13	16	12	2	0	52	
States with Loans	8	11	10	2	0	-	31	
States with "Large" Loans	2	6	5	1	0	-	14	
State Borrowing Activities 1990-1993								
Initial RRMs	0	9	22	18	3	0	52	
States with Loans	-	4	3	0	0	-	7	
States with "Large" Loans	-	2	0	0	0	-	2	

Source: All data on trust fund reserves and loans from the UI Service of the U.S. Department of Labor. Data exclude the Virgin Islands whose program was founded in 1977. Large loans are defined as total borrowing over the indicated periods equal to one percent or more of total payrolls for a single year in the indicated periods, respectively 1975, 1984 and 1991.

Table 3. Summary of Net Reserves by State, December 1989 and December 1992

STATE	Tax Base Index	Net Reserves (millions)			Reserve Ratio Multiple			URates 1990-92/ 1987-89
		Dec 1989	Dec 1992	Change	1989	1992	Change	
MICHIGAN		370	-72	-442	0.13	-0.02	-0.15	1.116
CONNECTICUT		274	-653	-927	0.22	-0.50	-0.73	1.947
OHIO		778	602	-176	0.30	0.21	-0.09	1.037
ARKANSAS		131	81	-50	0.40	0.21	-0.19	0.934
DIST OF COL		76	-19	-95	0.40	-0.10	-0.50	1.405
WEST VIRGINIA		146	141	-5	0.41	0.35	-0.06	1.019
LOUISIANA		306	601	295	0.43	0.72	0.29	0.693
MASSACHUSETTS		909	-380	-1289	0.45	-0.18	-0.63	2.236
ILLINIOS		1268	848	-421	0.47	0.28	-0.19	1.035
MISSOURI		372	3	-369	0.50	0.00	-0.50	1.028
MINNESOTA	Yes	359	224	-135	0.52	0.29	-0.23	1.093
PENNSYLVANIA		1616	808	-808	0.55	0.25	-0.30	1.297
MONTANA	Yes	80	96	16	0.63	0.64	0.01	0.970
SOUTH CAROLINA		415	433	18	0.66	0.61	-0.05	1.154
KENTUCKY		393	364	-29	0.69	0.56	-0.13	0.877
NORTH DAKOTA	Yes	45	50	5	0.69	0.67	-0.02	0.909
WYOMING	Yes	54	110	56	0.71	1.22	0.52	0.756
TEXAS		989	586	-402	0.73	0.36	-0.37	0.902
MARYLAND		598	146	-452	0.75	0.17	-0.58	1.387
COLORADO		239	339	100	0.75	0.91	0.15	0.796
NEW YORK		3181	214	-2967	0.76	0.05	-0.71	1.476
ARIZONA		493	372	-120	0.84	0.56	-0.27	1.037
CALIFORNIA		5419	2787	-2633	0.89	0.41	-0.48	1.380
NEW HAMPSHIRE		204	130	-74	0.89	0.56	-0.32	2.400
TENNESSEE		657	603	-54	0.90	0.73	-0.17	1.041
NEBRASKA		127	161	34	0.93	1.00	0.08	0.671
RHODE ISLAND	Yes	304	104	-199	0.93	0.32	-0.60	2.227
ALASKA	Yes	180	232	52	0.93	1.06	0.12	1.005
MAINE		206	35	-171	0.94	0.15	-0.78	1.632
GEORGIA		1018	966	-52	0.97	0.82	-0.15	1.032
WASHINGTON	Yes	1364	1766	402	0.97	1.04	0.06	0.937
INDIANA		770	942	171	1.04	1.14	0.10	1.083
NEW JERSEY	Yes	2795	2440	-355	1.06	0.87	-0.19	1.664
NEVADA	Yes	321	234	-87	1.12	0.68	-0.44	1.047
VIRGINIA		718	507	-212	1.16	0.75	-0.41	1.366
WISCONSIN		1041	1195	154	1.17	1.17	0.00	1.007
DELAWARE		207	214	6	1.19	1.09	-0.10	1.685
NORTH CAROLINA	Yes	1471	1387	-83	1.20	1.02	-0.18	1.362
IOWA	Yes	518	615	98	1.20	1.24	0.04	0.943
ALABAMA		623	550	-72	1.21	0.93	-0.28	0.965
UTAH	Yes	239	342	104	1.25	1.47	0.22	0.885
FLORIDA		2041	1444	-597	1.30	0.82	-0.48	1.345
OKLAHOMA	Yes	323	419	96	1.34	1.54	0.20	0.910
OREGON	Yes	804	1055	251	1.35	1.51	0.16	1.070
KANSAS		472	606	134	1.35	1.50	0.15	0.943
IDAHO	Yes	220	240	20	1.37	1.22	-0.15	0.967
HAWAII	Yes	340	362	22	1.40	1.37	-0.03	1.058
SOUTH DAKOTA		45	50	5	1.47	1.36	-0.12	0.811
NEW MEXICO	Yes	174	239	65	1.48	1.73	0.25	0.857
VERMONT		197	181	-16	1.59	1.40	-0.19	1.783
MISSISSIPPI		388	345	-43	1.67	1.30	-0.37	0.916
PUERTO RICO		564	749	186	1.91	2.20	0.29	NA
VIRGIN ISLANDS	Yes	28	47	19	2.65	3.38	0.73	NA
U.S.Total		36871	25842	-11029	0.85	0.57	-0.28	1.156

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MARYLAND		598	146	-452	0.75	0.17	-0.58	1.387
DIST OF COL		76	-19	-95	0.40	-0.10	-0.50	1.405
MISSOURI		372	3	-369	0.50	0.00	-0.50	1.028
FLORIDA		2041	1444	-597	1.30	0.82	-0.48	1.345
CALIFORNIA		5419	2787	-2633	0.89	0.41	-0.48	1.380
NEVADA	Yes	321	234	-87	1.12	0.68	-0.44	1.047
VIRGINIA		718	507	-212	1.16	0.75	-0.41	1.366
MISSISSIPPI		388	345	-43	1.67	1.30	-0.37	0.916
TEXAS		989	586	-402	0.73	0.36	-0.37	0.902
NEW HAMPSHIRE		204	130	-74	0.89	0.56	-0.32	2.400
PENNSYLVANIA		1616	808	-808	0.55	0.25	-0.30	1.297
ALABAMA		623	550	-72	1.21	0.93	-0.28	0.965
ARIZONA		493	372	-120	0.84	0.56	-0.27	1.037
MINNESOTA	Yes	359	224	-135	0.52	0.29	-0.23	1.093
NEW JERSEY	Yes	2795	2440	-355	1.06	0.87	-0.19	1.664
VERMONT		197	181	-16	1.59	1.40	-0.19	1.783
ARKANSAS		131	81	-50	0.40	0.21	-0.19	0.934
ILLINIOS		1268	848	-421	0.47	0.28	-0.19	1.035
NORTH CAROLINA	Yes	1471	1387	-83	1.20	1.02	-0.18	1.362
TENNESSEE		657	603	-54	0.90	0.73	-0.17	1.041
MICHIGAN		370	-72	-442	0.13	-0.02	-0.15	1.116
IDAHO	Yes	220	240	20	1.37	1.22	-0.15	0.967
GEORGIA		1018	966	-52	0.97	0.82	-0.15	1.032
KENTUCKY		393	364	-29	0.69	0.56	-0.13	0.877
SOUTH DAKOTA		45	50	5	1.47	1.36	-0.12	0.811
DELAWARE		207	214	6	1.19	1.09	-0.10	1.685
OHIO		778	602	-176	0.30	0.21	-0.09	1.037
WEST VIRGINIA		146	141	-5	0.41	0.35	-0.06	1.019
SOUTH CAROLINA		415	433	18	0.66	0.61	-0.05	1.154
HAWAII	Yes	340	362	22	1.40	1.37	-0.03	1.058
NORTH DAKOTA	Yes	45	50	5	0.69	0.67	-0.02	0.909
WISCONSIN		1041	1195	154	1.17	1.17	0.00	1.007
MONTANA	Yes	80	96	16	0.63	0.64	0.01	0.970
IOWA	Yes	518	615	98	1.20	1.24	0.04	0.943
WASHINGTON	Yes	1364	1766	402	0.97	1.04	0.06	0.937
NEBRASKA		127	161	34	0.93	1.00	0.08	0.671
INDIANA		770	942	171	1.04	1.14	0.10	1.083
ALASKA	Yes	180	232	52	0.93	1.06	0.12	1.005
COLORADO		239	339	100	0.75	0.91	0.15	0.796
KANSAS		472	606	134	1.35	1.50	0.15	0.943
OREGON	Yes	804	1055	251	1.35	1.51	0.16	1.070
OKLAHOMA	Yes	323	419	96	1.34	1.54	0.20	0.910
UTAH	Yes	239	342	104	1.25	1.47	0.22	0.885
NEW MEXICO	Yes	174	239	65	1.48	1.73	0.25	0.857
LOUISIANA		306	601	295	0.43	0.72	0.29	0.693
PUERTO RICO		564	749	186	1.91	2.20	0.29	NA
WYOMING	Yes	54	110	56	0.71	1.22	0.52	0.756
VIRGIN ISLANDS	Yes	28	47	19	2.65	3.38	0.73	NA
U.S.Total		36871	25842	-11029	0.85	0.57	-0.28	1.156

Table 4. Recession-Related Changes in Unemployment and UI Trust Fund Reserves

Ratios of Average State Unemployment Rates for Indicated Periods

Annual Averages	Below 0.75	0.75 - 0.999	1.00 - 1.249	1.25 - 1.499	1.50 - 1.749	1.75 - 1.999	2.00 and Above	State Median	U.S. Total
1971-1973 over 1967-1969	0	2	12	15	12	3	7	1.45	1.51
1974-1976 over 1971-1973	0	6	13	21	8	3	0	1.33	1.33
1981-1983 over 1977-1979	0	2	13	12	12	11	1	1.52	1.42
1990-1992 over 1987-1989	2	17	16	8	3	2	3	1.11	1.16

Changes in State UI Reserve Ratio Multiples

End-of-Year Changes	Increase	0.00 - -0.249	-0.25 - -0.499	-0.50 - -0.749	-0.75 - -0.999	-1.00 - -1.499	-1.50 or More	State Median	U.S. Total
1969 to 1973	1	4	12	13	9	10	2	-0.66	-0.65
1973 to 1976	1	4	2	10	12	13	9	-0.92	-0.98
1979 to 1983	10	6	10	9	3	10	3	-0.49	-0.62
1989 to 1992	14	19	10	7	1	0	0	-0.16	-0.28

Source: Calculations performed at the Urban Institute using data from the U.S. Department of Labor. State unemployment rate estimates for several smaller states prior 1976 made at the Urban Institute. All calculations refer to the fifty states plus the District of Columbia.

Table 5. Estimated State UI Experience Rating Indexes, 1988 to 1992

STATE	1988	1989	1990	1991	1992	Avg.
ALABAMA	71	78	74	52	49	65
ALASKA	a	a	a	a	a	a
ARIZONA	80	80	83	78	69	78
ARKANSAS	48	47	56	60	58	54
CALIFORNIA	65	67	68	64	52	63
COLORADO	45	53	60	65	64	57
CONNECTICUT	62	64	58	47	42	55
DELAWARE	INA	51	71	70	INA	64c
DIST OF COL	47	56	72	72	62	62
FLORIDA	68	66	50	56	53	59
GEORGIA	61	65	62	65	52	61
HAWAII	71	56	66	63	32	58
IDAHO	55	64	58	53	44	55
ILLINIOS	83	86	85	80	79	83
INDIANA	81	91	94	84	78	86
IOWA	78	77	67	70	74	73
KANSAS	64	73	69	69	57	66
KENTUCKY	79	79	75	72	58	73
LOUISIANA	42	87	85	88	83	77
MAINE	62	60	60	52	41	55
MARYLAND	INA	72	54	62	65	63c
MASSACHUSETTS	55	54	50	40	43	48
MICHIGAN	80	67	72	70	63	70
MINNESOTA	67	66	69	62	58	64
MISSISSIPPI	40	54	53	42	51	48
MISSOURI	61	58	59	61	55	59
MONTANA	54	58	62	61	55	58
NEBRASKA	61	57	63	60	57	60
NEVADA	66	67	68	63	41	61
NEW HAMPSHIRE	INA	INA	81	72	55	69c
NEW JERSEY	INA	78	75	70	63	72c
NEW MEXICO	51	59	63	63	62	60
NEW YORK	80	73	61	55	51	64
NORTH CAROLINA	INA	INA	INA	62	37	50c
NORTH DAKOTA	62	65	57	64	60	62
OHIO	70	74	74	70	65	71
OKLAHOMA	50	64	60	48	31	51
OREGON	59	63	56	60	51	58
PENNSYLVANIA	66	69	65	62	56	64
PUERTO RICO	b	b	b	b	b	b
RHODE ISLAND	75	69	68	58	55	65
SOUTH CAROLINA	58	62	65	61	54	60
SOUTH DAKOTA	61	38	48	45	49	48
TENNESSEE	INA	69	66	68	71	68c
TEXAS	53	58	55	52	51	54
UTAH	61	70	70	69	68	68
VERMONT	70	66	63	58	54	62
VIRGINIA	65	68	70	61	51	63
VIRGIN ISLANDS	INA	INA	INA	INA	INA	INA
WASHINGTON	60	63	63	61	57	61
WEST VIRGINIA	83	51	56	58	56	61
WISCONSIN	90	82	78	66	65	76
WYOMING	38	62	INA	55	63	54c
U.S. Aggregate	63	69	66	62	56	63
Simple Avg of States-d	62	66	66	62	56	62

Source: Data published by the Unemployment Insurance Service of the U.S. Department of Labor.

a - Index cannot be computed due to type of experience rating system.

b - All employers taxed at uniform rates in these years.

c - Average computed for two, three or four years as indicated.

d - Simple average for states with an estimated ERI for the year.

* U.S.G.P.O.:1996-403-281:40538 VOL.I