SUMMARY

The Unemployment Insurance (UI) system has come under heavy financial pressure in recent years. Annual outlays have frequently surpassed revenues (see Summary Table 1), and over half of the state Unemployment Insurance programs are currently insolvent. Several state UI programs have required large loans from the federal portion of the UI program, which also has needed loans from the general fund. Although no new federal borrowing is expected in the near future--except to provide additional funds for loans to the states--state loans outstanding are projected to continue to rise from \$13.7 billion in March 1983 to nearly \$19 billion at the end of fiscal year 1985 before beginning to decline.

Cyclical swings are reflected in the design of the UI system, which is intended to run deficits during periods of high unemployment and to offset them with surpluses during times of low unemployment. The recent big shortfalls are largely the result of unusually high unemployment and frequent periods of economic downturn that have not allowed the system to recoup its financial losses (see Summary Figure 1). The state and federal UI programs should all have an annual financial surplus when joblessness drops to about 9 percent. If current economic projections prove to be wrong, however, and the recovery is not sustained, UI financial difficulties could persist and even grow worse.

STRUCTURE OF THE UI SYSTEM

Unemployment Insurance is a joint federal-state responsibility. The federal government provides general guidelines and some restrictions on the operation of the state programs; it also funds benefits to certain unemployed workers and has financial responsibility for administration of the entire system. Within the constraints of federal law, states operate their own programs, establishing eligibility requirements and the duration and amount of weekly compensation. Because of restrictions limiting benefits to experienced workers who are involuntarily unemployed, only about 40 to 50 percent of unemployed workers usually receive regular UI benefits.

At present there are three tiers of benefits. Regular benefits are usually available for up to 26 weeks, financed by state payroll taxes on employers. Extended Benefits (EB) are provided in states with high unemployment rates for up to an additional 13 weeks, funded equally by

SUMMARY TABLE 1. UNEMPLOYMENT INSURANCE OUTLAYS AND REVENUE, 1976-1986 (In billions of dollars)

Fiscal Year	State Programs		Federal Program		Total Revenue Less Total Outlays a/
	Outlays	Payroll Tax Revenue	Outlays	Payroll Tax Revenue	
			Actual		
1976	11.6	6.4	6.4	1.5	-10.1
1977	9.9	9.3	4.2	1.9	-2.9
1978	8.8	11.0	2.3	2.6	2.5
1979	8.8	12.3	1.8	2.9	4.6
1980	13.6	11.9	2.5	3.2	-1.0
1981	14.6	12.4	3.2	3.3	-2.1
1982	20.2	12.8	3.1	3.2	-7.3
			Projected		
1983	24.8	15.0	4.3	4.5	-9.6
1984	22.4	18.7	4.2	5.2	-2.7
1985	21.6	22.7	3.3	6.0	3.8
1986	21.3	25.5	3.3	7.8	8.7

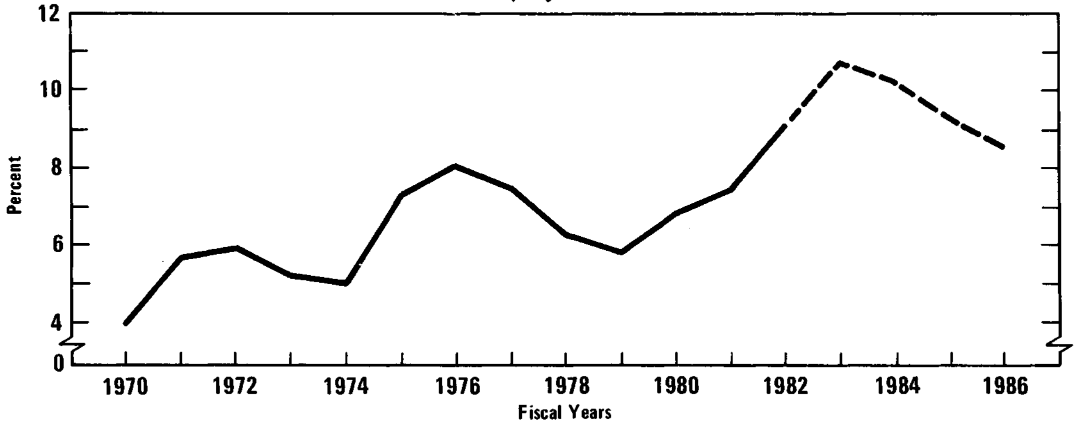
SOURCE: Actual figures from the U.S. Department of Labor, Unemployment Insurance Service for 1976-1982, and Congressional Budget Office estimates for 1983-1986.

a. Includes both state and federal UI revenues and outlays.

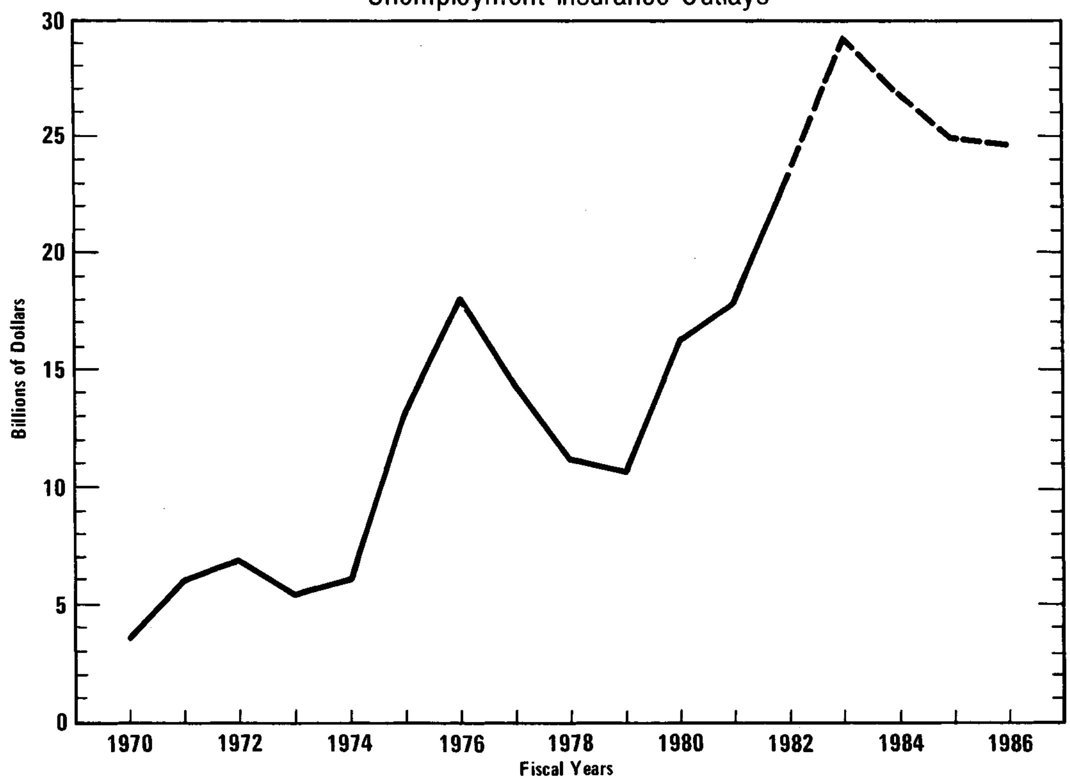
Summary Figure 1.

Unemployment Rate and Unemployment Insurance Outlays

Unemployment Rate



Unemployment Insurance Outlays



SOURCES: U.S. Department of Labor, Unemployment Insurance Service, for past UI outlays, and Congressional Budget Office for the remaining data.

state and federal payroll taxes. A third tier of benefits, Federal Supplemental Compensation (FSC), runs for up to 14 weeks and is paid out of federal general revenues, but is authorized only through the end of fiscal year 1983. Both state and federal benefits are counted in the unified federal budget because they flow through the federal Unemployment Trust Fund.

OPTIONS FOR FINANCIAL STABILITY AND REEMPLOYMENT AID

Although the UI system is currently in deficit, whether or not it requires legislative change is not clear. The program's recent financial problems stem largely from the very high unemployment levels and frequent recessions that have kept it running deficits. One solution for its financial problems would be for the federal government to follow broader policies that would reduce unemployment and increase economic growth. In any case, if the system is to continue to be funded from payroll tax revenues, the inflows must correspond over time to the outflows.

Another concern is that the UI program provides a disincentive to work because it reduces the cost of being unemployed. This effect means that unemployment is somewhat higher than would occur in the absence of the program. On the other hand, reducing benefits at the present time might be ill-advised, since the lack of job opportunities makes it unlikely that large numbers of unemployed could react to benefit cuts by finding jobs.

In response to these concerns, various proposals have been made to reduce Unemployment Insurance shortfalls and expand the role of UI in helping recipients find jobs (see Summary Table 2). Most of them would change federal UI laws to improve the financial situation of state programs, either by supplementing their revenues or by reducing their outlays. Other options would expand the UI program beyond its current income-support role to help workers find jobs.

Modifications Affecting UI Revenues

Some proposals would increase revenues or change the relationship between the Unemployment Trust Fund and the federal general fund.

Index the UI Taxable Wage Base. UI benefits have risen over time largely because of increases in nominal wages. Linking changes in the federal taxable wage base to changes in wages would tie federal UI revenues more closely to benefits. Because the federal wage base is also the minimum base used for state UI taxes, the tax base in most state programs would also increase, raising state revenues as well. The tax base for Social Security is currently tied to wage changes in this manner. Indexation beginning in 1984 would add $800 million to UI revenues in that year. On the other hand, increasing the UI tax at the present stage of economic recovery could have adverse effects on employment gains.

Return Income Tax Revenue to the UI System. UI benefits paid to moderate- and high-income recipients have been subject to the federal income tax since 1979. Returning to the Trust Fund that portion of the federal tax paid on UI benefits--as was recently enacted for Social Security--would bolster UI revenues, especially during times of economic downturn when benefit payments are large. This revenue could then be returned to state UI programs, where most of it originated as benefits. The Treasury Department estimates that this change would increase UI revenues by $1.7 billion in fiscal year 1984. On the other hand, earmarking part of the federal income tax would reduce flexibility in the use of general revenues, especially if this was done for several programs.

Finance Extensions of Benefits from Federal General Revenues. Either the state share of Extended Benefits, or both the state and federal shares of EB, could be financed with federal general funds when the national unemployment rate exceeded a certain level--8 percent, for example. One reason for this approach is that economywide high unemployment is primarily a national problem, which is affected by national economic policies and priorities. If both the state and federal shares of EB were financed from general revenues, the cost to the federal treasury would be about $1.7 billion in fiscal year 1984. If only the state share of EB outlays was financed in this manner, the cost would be about half that amount. Such general-revenue funding would be a departure from the self-financing principle of the UI program, however, and could eventually add to already high budget deficits, since states would not need to raise payroll taxes to pay for these benefits.

Forgive Certain Outstanding General-Revenue Loans. During the recession of the mid-1970s, the federal UI program borrowed heavily from the general fund to finance benefit extensions. This borrowing included a $5.8 billion loan for the payment of Federal Supplemental Benefits--a program similar to the present FSC program, which is funded from federal general revenues. If this $5.8 billion general-revenue loan was forgiven, the federal tax on all employers could soon be reduced by one-quarter, or 0.2 percentage points--the amount of the penalty tax imposed to repay the federal UI debt. Alternatively, the penalty tax could be maintained only in states with outstanding UI loans, and these funds used to repay state borrowing. If the loan was forgiven and the penalty tax removed, federal revenues would fall by about $600 million in fiscal year 1985--the first year

SUMMARY TABLE 2. COMPARISON OF SELECTED OPTIONS FOR UNEMPLOYMENT INSURANCE

Option	UI Benefits or Tax Revenue	UI Trust Fund Balance	Federal Budget Deficit	Employment Opportunities
	Direct Effects in Fiscal Year 1984 on:			
		Revenue Changes		
Index Federal Taxable Wage Base	Revenue increase of $800 million	Increase of $800 million	Reduction of $800 million	Slight reduction due to higher labor costs
Return Income Tax Revenue to UI System	None	Increase of $1.7 billion	None a/	None
Finance Benefit Extensions from General Revenue	None	Increase of $1.7 billion if all of EB paid	None a/	None
Forgive Certain General-Revenue Loans	Revenue reduction of $600 million (in FY85) if penalty tax is removed	Reduction of Trust Fund loan by $5.8 billion; possible reduction of balance by $600 million (in FY85)	Increase of $600 million (in FY85) if penalty tax is removed a/	Slight increase due to lower labor costs
		Benefit Changes		
Establish Two-Week Waiting Period	Reduction in benefits of $1.1 billion	Increase of $1.1 billion	Reduction of $1.1 billion	None

(Continued)

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Limit Weekly Benefit to 50 Percent of Average Wage in State	Reduction in benefits of over $1.2 billion	Increase of over $1.2 billion	Reduction of over $1.2 billion	None
Provide Variable Maximum Duration for EB Benefits	Reduction of EB benefits by up to $500 million	Increase of up to $500 million	Reduction of up to $500 million	None
		Changes to Promote Employment		
Use UI as an Employment Voucher	Possible increase in benefits, depending on plan	Reduction from increased administrative costs and possibly from higher benefits	Some increase, partially offset by increased income tax revenue	Increase by offering subsidies to employers
Use UI for Relocation or Retraining	Increase in benefits of $165 million	Reduction of $165 million	Increase of $165 million, partially offset by increased income tax revenue	Increase by helping to relocate workers or improve skills
Promote UI Work-Sharing Programs	None	Some reduction due to higher administrative costs	Small increase	Reduce chance of complete loss of jobs

a. Future deficits could be increased, however, because the option would either reduce future sources of revenue or would increase future outlays.

this change would likely be in effect. If the portion of the penalty tax collected in debtor states was used to repay state loans, about $350 million in outstanding loans could be repaid in that year, and federal revenues would fall only about $250 million.

Changes in Benefits

In the past, the federal government has not maintained close control over UI benefit provisions, since most benefits are paid under state programs and since benefit levels in federal programs equal state benefits. The federal government has, however, limited the availability of federal-state Extended Benefits. Restricting the availability of regular benefits or further limiting extended benefits could reduce UI outlays and help improve the financial condition of the system.

Require a Two-Week Waiting Period Before Regular Benefits Are Available. About three-quarters of the states now require beneficiaries to wait one week before beginning to collect regular benefits; the remaining states have no waiting-period requirement. If all state programs required a two-week waiting period, total benefits would be reduced for persons whose unemployment lasted less than the maximum compensable period, while they would not be changed for jobless persons who use all of their eligibility. Outlays for regular UI would be reduced by about $1.1 billion in fiscal year 1984.

Limit Wage Replacement to 50 Percent. The maximum weekly benefit a jobless person can receive differs significantly among the states. Thirty-six states have flexible maximum benefits--which vary over time with the average weekly wage in the state--ranging from 50 percent to 70 percent of average wages. Limiting the maximum weekly benefit to 50 percent of a state's average weekly wage would increase the uniformity of state programs, but would reduce benefits for some unemployed persons in 30 of 36 states with flexible maximum benefits, plus certain persons in the remaining states where the pre-set maximum benefit would otherwise be higher. Regular UI benefits would be reduced by this change by over $1.2 billion in fiscal year 1984.

Further Restrict Extended Benefits. Given the reductions in Extended Benefits that have already been made, and the relatively small size of that program compared to the regular one, major savings cannot be easily obtained in EB. Nonetheless, certain modifications could be made to target spending on areas of highest unemployment and to reduce benefits somewhat. The maximum duration of EB could range from 8 to 13 weeks, for example, depending on the state unemployment rate--instead of the current provisions under which EB is either not available or available for up to 13 weeks. This change could reduce benefits for some long-term jobless persons, however. The savings would depend on the levels of unemployment that would trigger the various EB durations; the particular trigger rates described in the text would save roughly $500 million in 1984, for example.

Changes Affecting Employment Opportunities

Other modifications in the UI system could allow funds to be used in a more aggressive promotion of reemployment. This approach might be targeted on the long-term jobless--those collecting regular UI for more than four months, for example, or EB recipients, most of whom have been without work for six months or more. The federal government could also promote the use of so-called shared-work programs that would distribute employment reductions among a larger share of the work force.

Use UI Funds as a Wage Subsidy for Employers. One option to spur reemployment would be to allow long-term UI recipients the option to transfer part of their benefit entitlement to a voucher payable to new employers. The amount of the voucher could be set in different ways--it could be a fixed amount per worker, for example, or it could equal the worker's remaining UI entitlement. The cost of this option would depend on the specific features of the subsidy, but could be made to add little to total program costs because continued UI benefits would likely be paid to many of these recipients if the vouchers were not available. In addition, the federal government would recoup some of the subsidy in the form of increased income taxes if the vouchers led to a net decline in unemployment. Given past experience with targeted employment programs, however, it is not clear this program would create many new jobs. Employers might receive the subsidy for hiring workers they would have hired without the voucher, or subsidized hiring might merely cause joblessness for some other workers.

Use UI Funds to Facilitate Relocation or Retraining. Another option would be to allow long-term UI recipients to receive their remaining benefits in a single payment to be used either for relocation to an area with lower unemployment, or for retraining. While UI benefits can now be transferred from one state to another if a recipient moves, after several weeks of joblessness an unemployed worker may lack the funds necessary to relocate. Alternatively, the lump-sum payment could be used to pay for training that would improve the worker's chances of being reemployed. As with the voucher program, the cost of this option would depend on the amount of the cash payments: if, for example, EB recipients were allowed to receive their full benefit in advance for relocation or retraining, program costs could increase about $165 million in 1984.

Promote Work-Sharing Programs. A different approach would be for the federal government to facilitate the use of work-sharing programs, such as those developed in Arizona, California, and Oregon. These plans allow certain employers to reduce staff hours across the board rather than laying off some people entirely, and then permit employees to receive pro-rated UI benefits for their lost hours of work. In order to expand these plans beyond the present small number of states, UI laws in other states that prohibit persons who work more than some minimum amount from receiving benefits would have to be changed, and additional program rules developed. The Congress has already directed the Department of Labor to formulate model legislation for state work-sharing programs, and additional aid could be provided to help states implement and finance such programs.