
CHAPTER IV. OPTIONS TO REGAIN FINANCIAL STABILITY AND PROMOTE EMPLOYMENT

While the UI system has been self-financing throughout most of its over 40 years of existence, economic and program conditions during the last few years have resulted in large drains on the system's resources. The program has also been criticized by some for not aiding recipients in finding jobs.

This chapter presents several options for helping the financial status of the UI system and for using the system to promote employment more actively. The options considered include:

- o Modifications affecting revenues;
- o Changes affecting benefits; and
- o Other changes affecting employment opportunities.

Perhaps the most severe problem facing the UI system is that of restoring solvency to several state programs. Many of the financial options in this chapter address this need by considering ways the federal government might bolster state revenue or limit outlays. The federal portion of UI is in better financial shape than many of the state programs, and options for this part of the program consist of ways to reduce past debts and provide additional federal funds for state loans.

Although some of the options would reduce the overall federal deficit, the primary emphasis is on program solvency and the needs of the unemployed. Table 10 details the effects of the considered financial options on both the Unemployment Trust Fund balance and the overall federal budget.

MODIFICATIONS AFFECTING REVENUES

Sources of revenue to the Unemployment Trust Fund include federal and state payroll taxes and, in recent years, federal general revenues to finance the payment of certain extensions of benefits. Options that could affect these revenues include those to:

TABLE 10. EFFECTS OF SELECTED UI OPTIONS ON UNEMPLOYMENT TRUST FUND BALANCES AND THE OVERALL FEDERAL BUDGET (By fiscal year, in billions of dollars)

Option	Unemployment Trust Fund Balance		Overall Federal Revenue Less Outlays	
	1984	Annual Average 1986-1988	1984	Annual Average 1986-1988
Revenue Changes				
Index Federal Taxable Wage Base	0.8	2.7	0.8	2.7
Return Income Tax Revenue to UI System	1.7	1.5	0	0
Finance Benefit Extensions from General Revenue	1.7	0.7	0	0
Forgive Certain General-Revenue Loans <u>a/</u>	0	-1.3	0	-1.3
Benefit Changes				
Establish Two-Week Waiting Period	1.1	1.0	1.1	1.0
Limit Weekly Benefit to 50 Percent of Average Wage in State	1.2	1.1	1.2	1.1
Provide Variable Maximum-Duration Extended Benefits	0.5	0.2	0.5	0.2

SOURCE: Congressional Budget Office.

- a. Also assumes the net federal payroll tax would be reduced by that amount now earmarked to repay the general-revenue loan.

- o Index the federal UI taxable wage base to changes in average wages; and
- o Modify the relationship between the Trust Fund and the federal general fund.

Index the UI Taxable Wage Base

UI benefits now depend in large part on past wage levels, because the weekly benefit amount is determined primarily by previous wages, and also because the maximum benefit is often tied to average wages in the state. Indexing the federal taxable wage base--which also serves as the minimum wage base for state UI taxes--to average wages in the national economy would help to tie UI revenues to changes in wages as well. ^{1/} This method is currently used to determine the taxable wage base for Social Security.

The federal UI taxable wage base has been increased only three times from its \$3,000 level in 1940. The wage base of \$7,000 in 1983 results in taxable wages being only about 40 percent of average annual wages in covered employment, down from 48 percent in 1970 and 93 percent in 1940. At the same time, state tax rates have increased significantly in recent years: the average state tax as a fraction of taxable wages, for example, has increased from 1.3 percent in 1970 to 2.5 percent in 1982.

A major result of indexing the federal taxable wage base would be to increase state tax bases as well. These increases would have larger dollar impacts on tax revenues than would an increase in the federal base, because the average state tax rate is much larger than the federal rate--2.5 percent compared to 0.7 percent in 1982, for example. On the other hand, increased state UI tax revenues would result in lower state UI tax rates on employers because the improved financial condition of state UI programs would shift states to lower tax-rate schedules.

If the federal UI taxable wage base was indexed to changes in average wages in the economy beginning in fiscal year 1984, additional revenues of \$800 million would be available to the UI system in fiscal year 1984 and a total of \$10.5 billion in additional revenues would be available during the

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1. Increases in the federal tax rate on employers would also increase federal revenues; however, changing the federal tax rate would have no effect on state payroll tax revenues because state and federal tax rates are not tied together as are the tax bases.

1984-1988 period. 2/ By 1988, the taxable base would be about \$9,200, compared to \$7,000 under current law.

An increase in state tax bases compared to an increase in the average state tax rate would affect different employers differently, depending on whether they were high- or low-wage firms and whether their UI benefit-cost levels were high or low. Because of the large differences in state tax systems, however, generalizations cannot easily be made about which firms would be helped and which would be hurt by these changes. 3/

Some persons favor indexation of the federal UI wage base because they feel the base now is so low that it effectively limits the amount of experience rating of state taxes that occurs. Other proponents believe indexation would result in increased taxes for high-wage, stable employers, and favor this change because they feel these employers can afford the added costs most easily. On the other hand, opponents maintain that, because UI is an insurance system, most of the cost increases should be paid by those employers responsible for the added benefits. Some also contend that, because increasing taxes during the present economic recovery would have adverse effects on both employment and the recovery, any such increases should, at a minimum, be implemented with a lengthy delay.

Modify the Relationship Between the Unemployment Trust Fund and the Federal General Fund

Other changes could be made that would provide the Unemployment Trust Fund with additional resources from the federal general fund. Possible changes include those to:

- o Return to the Unemployment Trust Fund income tax revenues derived from the taxing of UI benefits;
- o Finance extensions of benefits from general revenues when unemployment is high; and

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2. Some states with financially stable UI programs would likely reduce their UI tax rate if the base was increased, thereby offsetting some of the effect of this change on tax revenues.
 3. See, for example, Joseph M. Becker, Unemployment Insurance Financing (American Enterprise Institute, 1981), pp. 111-128; and National Commission on Unemployment Compensation, Unemployment Compensation: Final Report (July 1980), pp. 80-86.

- o Forgive certain general-revenue loans to the Trust Fund.

All of these options share some common features. Each would add to Trust Fund revenues, especially during periods of economic downturn, and could help to reduce the cyclical instability of the UI system. Depending on how these added funds were used, the UI Trust Fund deficit could be reduced, UI taxes could be reduced, or benefits could be increased. While these options could help the UI system, however, they would simply shift revenues between different Treasury accounts. In addition, these changes would be contrary to the self-financing principle under which the UI system has operated in the past.

Return Income Tax Revenue to the UI System. Returning that portion of federal income taxes paid on unemployment benefits would be one way to increase Trust Fund revenues. These funds could then be added to state UI account balances. Certain UI benefits have been taxed since 1979, but the revenues generated are not now returned to the UI system. During 1979-1981, UI benefits were subject to at least partial taxation if a taxpayer's adjusted gross income, including UI benefits, exceeded \$20,000 for a single person and \$25,000 for a couple. One-half of each dollar of benefits over those limits, up to the full amount of the UI benefit, was included in the recipient's adjusted gross income for the purpose of federal income taxation. Beginning in 1982, the income thresholds above which UI benefits are subject to tax are \$12,000 and \$18,000, respectively.

If the funds generated by this portion of the federal income tax were returned to the UI Trust Fund, the Treasury Department estimates that UI revenues could be increased by \$1.7 billion in fiscal year 1984, and \$7.7 billion during the 1984-1988 period. If all UI benefits were subject to full taxation--not just those that increase incomes above \$12,000 or \$18,000--and if the proceeds were returned to the Trust Fund, those revenues could be increased by a total of \$4.4 billion in 1984.

Some persons maintain that this tax revenue should be returned to the UI program because it represents revenues primarily from state-financed benefits. Others favor the proposal because increased taxation of benefits was proposed as a way of offsetting additional Trust Fund spending for benefits, especially for the tax change beginning in 1982. Others object to the proposal because it would result in the earmarking of income tax revenue for special purposes and would reduce flexibility in the use of general revenues. A similar policy was recently enacted for the Social Security system, in which one-half of those benefits are subject to taxation on incomes exceeding \$25,000 for singles and \$32,000 for couples, with revenues generated being returned to the Social Security fund.

Finance Extensions of Benefits from Federal General Revenues. Using general revenues to finance extensions of benefits during periods of high unemployment would provide additional money to the Unemployment Trust Fund at times when outlays are greatest. Under this option, either the state and federal shares of extended benefits, or only the state share, could be paid from general revenues when the national unemployment rates exceeded a certain level--8 percent, for example. The present Federal Supplemental Compensation program is now financed from federal general funds, as were special programs in 1977-1978.

If both the state and federal shares of EB were financed with federal general funds, Trust Fund outlays would be reduced by \$1.7 billion in fiscal year 1984, and by a total of \$4.7 billion in the 1984-1988 period. If only the state share of EB was financed in this manner, Trust Fund outlays would be reduced by one-half of these amounts.

Some support this proposal with the view that unemployment--especially high unemployment--is primarily a national problem, which is affected by national economic policies and priorities, and therefore that general revenues should be used to finance extensions of benefits during these periods. Some also maintain that lengthy periods of unemployment for an individual--those over 26 weeks, for example--are less the responsibility of former employers than are the first few weeks, so that employers should not have to finance benefit extensions.

Opponents maintain that the UI system--including the Extended Benefit program--was designed to be self-financing and that the infusion of general revenues should not be needed. The payroll tax was an essential part of the UI system when it was first established, and the system has been able to perform satisfactorily for many years with only this source of funds. They maintain that, if additional benefits cannot be adequately financed by payroll tax revenues, those benefits should not be provided.

Forgive Certain Outstanding General Revenue Loans. The Unemployment Trust Fund borrowed \$9 billion from the federal general fund to pay the costs of federally funded benefits in the mid-1970s--including \$5.8 billion for federal supplemental payments and \$3.2 billion for the federal share of EB--and a debt of \$6.8 billion still remained at the end of 1982. As noted earlier, the Congress has enacted a temporary 0.2 percentage-point increase in the net federal UI payroll tax until this loan is repaid--which the Administration expects will be in 1987.

If the \$5.8 billion loan used to finance federal supplemental payments was forgiven, the federal payroll tax on employers could be reduced by 0.2 percentage points in the calendar year after the remaining EB loan was repaid--which will probably be in fiscal year 1984. Alternatively, the

Congress could continue that additional tax in states with outstanding UI loans from the Trust Fund, and reduce it only in states without such loans. The tax revenues so generated in the debtor states could be used to help repay their outstanding loans.

If the 0.2 percent added federal tax was removed beginning in calendar year 1985, federal UI payroll taxes could be reduced by \$600 million in fiscal year 1985, and by a total of \$4.5 billion in the 1985-1988 period. If that portion of the added federal tax collected in debtor states was used to help repay state loans, about \$350 million in outstanding state loans could be repaid in fiscal year 1985 and as much as \$800 million in fiscal year 1986. ^{4/}

Supporters contend that the debt to the general fund should be forgiven because it was incurred during a time of high national unemployment, when such benefit extensions should have been financed with general revenues. In addition, federal general revenues were used to pay for similar benefits later in the same recession and in the 1981-1982 downturn. If the added tax was used to repay state debts to the Trust Fund, it would also help debtor states regain financial stability without increasing state taxes. On the other hand, forgiving this general fund debt would add to future federal budget deficits in the sense that it would eliminate this source of revenue to the general fund.

CHANGES AFFECTING BENEFITS

Regular UI benefits are now determined by the states, with little input from the federal government. Recent increases in outlays for Extended Benefits, however, and the desire to contain federal spending overall, have prompted the Congress to restrict the availability of federal-state Extended Benefits. This section presents possible restrictions on regular state benefits and further changes in the Extended Benefit program.

Restrict Regular UI Benefits

The federal government could require that states, as a condition for approval of their UI programs, limit both the circumstances under which regular benefits are available to unemployed workers and the amounts of those benefits. Such restrictions might lower outlays--thereby helping to

4. A total of 36 states are projected by the Administration to have outstanding Trust Fund loans at the end of fiscal year 1984. See Department of Labor, UI Outlook (April 1983).

alleviate the financial problems of the system--while also reducing the work disincentive provided by the availability of UI benefits. On the other hand, the federal government has only infrequently exercised its power to make such restrictions beyond the initial establishment in 1935 of criteria for approval of state UI programs. Some persons feel this precedent should be maintained because each state has financial responsibility for the benefit and eligibility provisions in its laws. Further, some argue that labor-market conditions in various states are sufficiently different so that states are better able to design benefit standards to fit those conditions.

Specific restrictions on state benefits that might be implemented include those to:

- o Establish a two-week waiting period before UI benefits are available; and
- o Limit the maximum benefit level to 50 percent of the average weekly wage in the state.

Because these changes would require modifications in state UI laws, it would be necessary to allow for some delay in implementing them.

Establish a Two-Week Waiting Period Before Benefits Are Available. The federal government could require beneficiaries in all states to wait two weeks before their initial receipt of benefits. The maximum length of time jobless persons could collect benefits would not be affected by this change--for example, a person otherwise eligible for 26 weeks of benefits would remain eligible for that amount, but the payment period would represent weeks 3-28 of joblessness. Under current state laws, 42 states require beneficiaries to wait one week before receiving regular benefits; the remaining states have no waiting period. 5/

If this change was made, outlays for regular UI could be reduced by approximately \$1.1 billion in 1984 and by \$5.1 billion during the 1984-1988 period. This change would not reduce total benefits for persons whose unemployment lasted the maximum compensable time, although a two-week waiting requirement would add to a worker's initial cost of joblessness. The

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5. In seven of the 42 states with a one-week waiting period, beneficiaries are paid for the waiting week if they remain unemployed for a certain length of time--usually three weeks to nine weeks. The proposal considered here would not allow benefits to be paid for the two-week waiting period in any state.

change would also encourage faster job search--possibly while still employed--to avoid the period without income.

Limit Wage Replacement to 50 Percent. The largest weekly benefit a jobless person can currently receive differs significantly from state to state, and 36 states have a flexible maximum benefit that varies over time with the state's average weekly wage. These flexible maximums range from 50 percent to 70 percent of the average weekly wage in a state.

Limiting the maximum weekly benefit to 50 percent of a state's average weekly wage would reduce the weekly benefit for certain formerly higher-wage unemployed persons in 30 of the 36 states with flexible maximums, plus some similar persons in states where the pre-set maximum benefit would otherwise exceed half of the state's average weekly wage. This change would reduce regular UI benefits by over \$1.2 billion in 1984, and by over \$5.8 billion during the 1984-1988 period. 6/

Proponents maintain that this change would still allow the maximum benefit to differ among states, but would tie that maximum to the same share of average weekly wages. Others contend, however, that the change would severely hamper the ability of states to set benefit levels commensurate with the needs of their workers.

Restrict Extended Benefits

Extended Benefit program funds could be further targeted on high-unemployment areas by providing longer durations of EB in states with the highest jobless rates. Under current law, extended benefits are either not available in a state or are available for 13 weeks, depending on the state's insured unemployment rate (IUR) and the magnitude of the present rate compared to past rates. Instead, the maximum potential duration of these benefits could be made to vary--for example, between zero and 13 weeks--according to the state's IUR. 7/

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6. These figures underestimate the total savings from restricting the maximum weekly benefit because they include savings only for those persons who would otherwise receive a benefit equal to the state maximum. The total savings could be considerably larger.
 7. Recent diversions between the IUR and the total unemployment rate raise the question of the suitability of the IUR to scale benefit eligibility periods. See Gary Burtless, "Why Is Insured Unemployment So Low?" (The Brookings Institution, March 31, 1983).

The budget impact of this option would depend on the levels of insured unemployment that would trigger the various EB durations.^{8/} For example, if EB was available for up to 8 weeks in states with IURs between 4.5 percent and 5 percent, 10 weeks in states with IURs between 5 and 5.5 percent, and 13 weeks in states with IURs over 5.5 percent, there would be little change in EB outlays. If these IUR thresholds were 5, 5.5, and 6 percent, however, and 6.5 percent in states that do not meet the 120-percent rule, EB outlays could be reduced by \$500 million in fiscal year 1984 and \$1.8 billion in 1984-1988.

These changes would make the durations of benefits similar to those in the present Federal Supplemental Compensation program--where benefit durations are increased with state unemployment rates. On the other hand, they would mean reductions in benefit durations for many long-term jobless persons, if the changes were designed to reduce EB outlays.

OTHER CHANGES AFFECTING EMPLOYMENT OPPORTUNITIES

The UI system could be used to promote more aggressively the reemployment of long-term unemployed persons. Once persons are unemployed for three or four months or more, for instance, they may have little prospect of returning to their previous work. Such workers might be allowed the option of using their remaining regular benefit entitlement, or their Extended Benefit entitlement, for purposes other than weekly cash benefits. The funds could be used to help them find new employment, relocate, or acquire retraining. In addition, some UI funds could be used to promote so-called shared-work programs that would spread the costs of unemployment--and the benefits of employment--among more workers. These changes could be designed to have little effect on overall UI costs by diverting some of the funds otherwise likely to be paid out as benefits.

Use UI Funds as a Wage Subsidy for Employers

Long-term UI recipients could be allowed the option to transfer part of their benefit entitlements to vouchers payable to new employers. These vouchers could be redeemable on a portion of the workers' wages over

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8. The options considered here all retain the provision of current law making EB available if the state's IUR is at least 20 percent larger than during the same period of the last two years; if that is not the case, EB is available only if the state's IUR exceeds 6 percent in the first option and 6.5 percent in the second.

several weeks of employment to ensure that the new jobs were not short-term ones. Making them available only to new employers could limit possible abuses of the subsidy by employers who might otherwise cycle workers through jobless spells to receive the subsidy. The employment subsidy also could be limited to those employers that use it to expand their overall work force, and could be limited to a certain fraction of a firm's total work force. ^{9/}

The value of the voucher could be determined in one of several ways. For example, it could be a multiple of the worker's weekly benefit amount--currently about \$120 per week--with that multiple depending on the number of weeks of regular or extended UI the jobless worker had remaining. If the EB program was used, and if the worker had already collected 3 of the 13 weeks of benefits available, for instance, the value of the voucher would be \$1,200, on average. Alternatively, the value of the voucher could be set at a certain dollar amount.

A voucher could probably be designed to have little additional federal cost as long as the subsidy did not simply create unemployment among other workers. Eligible workers would already have been unemployed for several months and, if the vouchers were not available, benefit payments probably would otherwise have to be made to many of them. In addition, the federal government would recoup some of the wage subsidy in the form of increased personal income tax revenues. The subsidy would also reduce employers' business expense deductions for wages, further increasing federal tax revenues. On the other hand, if other workers were displaced by voucher recipients, this could add to UI costs.

If increases in overall employment were the primary objective of the voucher program, concern would need to be focused on the extent to which jobs subsidized by the program would have been created in any case, whether the jobs came at the expense of other workers, and whether the jobs lasted beyond the period of the subsidy. Although it is likely that during the current period of high unemployment many of those getting subsidized jobs would not otherwise have found work, some of them might be benefiting at the expense of other jobless persons who did not receive the wage subsidy. This could occur either because workers with vouchers would be hired instead of other jobless persons, or because workers with vouchers

9. As part of its 1984 budget proposal, the Administration proposed a voucher for FSC recipients. According to that plan, new employers would receive a tax credit equal to one-half of the worker's weekly FSC benefit for each week of new employment, up to the remaining dollar amount of the FSC entitlement.

would be hired to replace other employees. In addition, because UI recipients often have considerable work experience, they might be likely to use vouchers to obtain interim, rather than permanent, employment, later returning to their previous jobs or taking better jobs as they became available.

Proponents of this change maintain that it would be more efficient to use UI funds to promote reemployment than simply to compensate the jobless for remaining so. The perceived low added cost is also an appealing aspect of the voucher program to some. On the other hand, experience with past wage-subsidy programs--most notably the New Jobs Tax Credit in 1977-1978 and the present Targeted Jobs Tax Credit--has been mixed, with some indication that relatively small wage subsidies may not be effective in creating additional jobs in the economy. ^{10/} Some critics of the voucher proposal maintain that Unemployment Insurance is designed to compensate those who have lost their jobs, and not to finance their reemployment.

Use UI Funds to Promote Relocation or Retraining

Alternatively, long-term UI recipients could be allowed to receive at least part of their remaining entitlements as lump-sum payments to be used for relocation or for retraining. ^{11/} UI benefits can now be transferred from one state to another if the recipients move, but if jobless workers wait several weeks before deciding to relocate, they may lack the necessary funds. The lump-sum payment might also be used to pay for training that could improve the recipient's chances of being reemployed.

Geographic relocation might be the best option for certain long-term UI recipients whose skills are in demand in other regions of the country.

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10. For a discussion of the effectiveness of wage-subsidy programs in creating new jobs, see CBO, "Strategies for Assisting the Unemployed" (December 8, 1982), and Improving Youth Employment Prospects (February 1982). Studies have indicated that for the majority of firms the most important consideration in hiring decisions was the level of product demand, rather than the marginal cost of labor, and that, at least in the past, employers were extremely reluctant to increase hiring in response to a credit without confidence that the additional output produced could be sold for a profit.
 11. For a more detailed discussion of reemployment aid for experienced workers see CBO, Dislocated Workers: Issues and Federal Options (July 1982).

Relocation assistance could include subsidizing job-search costs and moving expenses. Similar aid is available to certain unemployed persons under the Trade Adjustment Assistance program--which pays 90 percent of reasonable job-search expenses up to \$600, plus 90 percent of additional relocation allowances and a lump-sum payment of up to \$600 to cover part of moving expenses. In addition, Title III of the Job Training Partnership Act provides aid for job-search, counseling, and training.

Long-term UI recipients whose employment problems derive from skills that are firm-specific or obsolete might be assisted in obtaining retraining. Such aid could promote either vocational training or on-the-job training, in addition to job-search assistance. Direct training in a particular skill would generally be most appropriate for this group of experienced workers, because they already have developed the basic skills and good work habits necessary for successful reemployment. Although the costs of those services could vary considerably with the type of assistance provided, vocational training costs could be about \$2,200 per worker in fiscal year 1984, while on-the-job training costs could equal about \$2,600--assuming earnings were subsidized to the amount of 30 percent for six months. 12/

If EB recipients were allowed to use their full entitlement for retraining or relocation, and if 50 percent used retraining aid and 5 percent relocation assistance, EB costs could increase by \$165 million in fiscal year 1984 as a result of these changes.

Share the Costs of Unemployment

The federal government could also encourage and work with states to implement so-called "work-sharing" programs. Such programs have been implemented in Arizona, California, and Oregon. They allow certain employers to reduce staff hours across the board rather than laying off some people entirely, and permit employees to draw prorated UI benefits for the lost hours of work. Under such a plan, for example, instead of 20 percent of a firm's employees being laid off, each employee's hours could be reduced by 20 percent and each would then receive 20 percent of the full UI benefit. The Tax Equity and Fiscal Responsibility Act of 1982 directed the Department of Labor to develop model legislation for state work-sharing programs, and additional aid could be provided to help states develop and implement such programs quickly.

12. See Abt Associates, Reemploying Displaced Workers: The Implementation of the Downriver Community Conference Economic Readjustment Program (1982) and CBO, Dislocated Workers.

Preliminary evidence indicates that this type of plan has been successful in California. ^{13/} First implemented in 1978, that program allows the payment of partial UI benefits for up to 20 weeks to workers whose hours are reduced because of a temporary slump in economic activity. In order to qualify, a worker must be eligible for UI and the normal workweek must be reduced by at least 10 percent. In the first two years of operation in California, about 1,300 work-sharing plans were approved affecting about 35,000 workers.

In order to extend these plans beyond the present small number of states, however, other states' laws that prohibit persons who work more than some minimum amount from receiving UI benefits would have to be changed. Substantial labor-management cooperation would also be required to make the plans work widely. Outlays for program administration could be increased by this option because of the increase in the number of persons who would receive partial UI benefits.

Proponents of the work-sharing option maintain that such programs could increase job security for workers, and reduce some costs for firms as well. For example, by retaining employees during temporary production cutbacks, firms could be saved the costs of recruiting, rehiring, and retraining new workers to replace experienced ones who found other jobs during their layoff. Employees could continue to receive medical coverage and other fringe benefits that would be expensive to obtain privately.

On the other hand, such plans would ignore established seniority systems and shift part of the burden of unemployment to more senior personnel. Some argue that work-sharing plans might also permanently increase employers' UI taxes by making them more willing to lay off workers.

13. For an analysis of the California plan, see State of California, Legislative Analyst, A Review of the Shared Work Unemployment Compensation Program (January 1981).