

# **Unemployment Insurance for the Great Recession**

Testimony for the  
Committee on Finance

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*by*

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# Unemployment Insurance for the Great Recession

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## Summary

Since December 2007 the U.S. unemployment rate has nearly doubled and the number of payroll jobs has fallen by 6.9 million, or 5%. The severity of the current recession makes it very hard for laid off workers to find new jobs. This has clear implications for the design of unemployment programs. For typical American workers the most important protection they receive when laid off is provided by unemployment insurance (UI). The regular UI program provides up to 26 weeks of benefits.

When unemployment is high and job finding is hard, many UI claimants exhaust their regular benefits. In the worst month following the 1981-82 recession, 41% of UI claimants exhausted their regular state UI benefits. In July of this year, nearly 51% of UI claimants exhausted their regular benefits. This is the highest rate of benefit exhaustion on record. It is a painful indicator of the difficulty of finding a job in the current economy. In view of the fact that the unemployment rate is still climbing and the number of payroll jobs is shrinking, the exhaustion rate is likely to continue rising in the coming months.

On both humanitarian and economic grounds it makes sense to provide longer duration benefits to laid-off workers when the unemployment rate is high. Because unemployed workers need more time to find work in weak labor markets, there is a compelling equity argument for offering insurance over longer spells of job search. In addition, the counter-cyclical effectiveness of unemployment compensation is reduced when a large percentage of laid-off workers is dropped from the rolls as a result of benefit exhaustion.

In 2008 and 2009 Congress authorized federally funded extensions of unemployment benefits through Extended Unemployment Compensation (EUC) and modifications in the Extended Benefits (EB) program. These programs provide federal funding for up to 53 weeks of EUC and EB benefits in addition to the 26 weeks funded by states under their regular UI programs. Authorization for EUC and 100%-federally-funded EB benefits will expire for workers who exhaust their regular unemployment benefits after December 31, 2009. The most urgent policy need right now is to extend the authorization for these programs until at least the end of the 2010 fiscal year. I expect the nation's unemployed will find it harder to land a job after December 31, 2009, than was the case when the EUC program was authorized in the summer of 2008. Thus, the arguments for maintaining the EUC program in 2010 are even more powerful than the arguments for establishing the program in the first place. The 2010 unemployment rate is likely to be substantially higher than it was in either 2008 or the winter of 2009. This consideration also implies it would be highly desirable to authorize continued federal funding for the recent expansions in the federal-state EB program. The EUC and modified EB programs should be authorized to provide benefits to new UI exhaustees until at least the end of the current fiscal year. Congress should consider trimming potential benefit durations only when unemployment comes down and laid-off workers find it easier to secure new jobs.

Critics of extended UI benefits claim they have little effect in boosting consumption and have serious adverse incentives in prolonging unemployment. In view of the severity of the current recession, I find little merit in either argument. Extended UI benefits provide crucial help to the Americans who have suffered the most in the recession – the laid-off workers who have been without work for six or more months. The benefit extensions enable these workers to maintain higher consumption than would be possible without the extra benefits.

### **The current recession and unemployment insurance**

Since the peak of the last economic expansion in December 2007 the U.S. unemployment rate has nearly doubled and the number of payroll jobs has fallen by 6.9 million. Over the same period the number of working-age Americans (those between ages 16 and 64) increased 0.8%. In order for the job market to absorb all the new entrants into the job market, employers should have created about 1% more jobs between December 2007 and August 2009. Instead, the number of payroll jobs declined 5%.

The current recession is on track to be the longest and most severe of the post-Depression era. Between the end of the Great Depression and 2007 America's worst recession occurred in 1981-82, when unemployment reached a peak rate of 10.8%. Assessed in terms of the rise in unemployment and the drop in payroll employment, however, the current recession is already longer and more severe than that earlier one. Chart 1 compares the change in the unemployment rate and in payroll employment in the two recessions. The top panel shows the percentage point difference between the unemployment rate at the business cycle peak and in the 11 months before and the 20 months after the business cycle peak. Although the unemployment rate initially rose more slowly in the current recession compared with the 1981-82 recession, by the 13<sup>th</sup> month of the recession the jump in unemployment was about the same in the two recessions. According to the National Bureau of Economic Research (NBER), the 1981-82 recession lasted 16 months and ended in November 1982. Soon after that month the unemployment rate began to decline. By the 20<sup>th</sup> month after the July 1981 business cycle peak, unemployment fell to 10.3%, one-half percentage point below the highest unemployment rate attained in the recession. At the comparable point in this recession, August 2009, the unemployment rate was 4.8 percentage points above the rate when the recession began, and it was still rising.

The trends in the unemployment rate are mirrored in the trends in payroll employment (see the lower panel of Chart 1). In the initial phase of the recession, payroll employment fell more slowly in this recession than it did in 1981-82. However, one year after the onset of both recessions the percentage drop in payroll employment was approximately the same. By the 20<sup>th</sup> month after the onset of the 1981-82 recession, payroll employment was beginning to rise. In this recession, however, payroll employment continued to decline in the 20<sup>th</sup> month, though the pace of decline was much slower than it had been between October 2008 and April 2009 (months 10 through 16 of the recession).

The severity of the current recession makes it very hard for laid off workers to find new jobs. This has clear implications for the design of temporary unemployment programs. For typical American workers the most important protection they receive when they are laid off is provided by unemployment insurance (UI). Experienced U.S. workers who are dismissed from their jobs can claim unemployment benefits that replace about half of their lost earnings up to a maximum weekly benefit amount. In most states this maximum amount is roughly half the wages earned by an average worker covered by the unemployment insurance system. This means laid off workers who earn above-average wages collect benefits that replace less than half of their lost earnings. Benefits are usually taxed as ordinary income in the income tax system. UI benefits do not last indefinitely. In normal labor markets, benefits are restricted to just 26 weeks. Laid off workers who fail to find work within six months after losing a job will run out of unemployment benefits before they start earning

earning another paycheck. In recent years between 31 percent and 43 percent of workers who claim unemployment benefits exhaust their eligibility for regular UI benefits before finding a job.

Not surprisingly, the percentage of workers exhausting benefits is higher when the nationwide unemployment rate is high. Chart 2 shows the fifty-year trend in the UI exhaustion rate as calculated by the U.S. Department of Labor Department. In the worst month following the 1981-82 recession, nearly 41% of UI claimants exhausted their regular state UI benefits. In July of this year, the Labor Department estimates that nearly 51% of UI claimants exhausted their regular benefits. This is the highest benefit exhaustion rate on record and is a painful indicator of the difficulty of finding a job in the current economy. In view of the fact that the unemployment rate is still rising and the number of payroll jobs is shrinking, it is likely the exhaustion rate will continue to increase in coming months.

Chart 2 shows that benefit exhaustion increases sharply late in recessions and in the early months of economic recoveries. For example, the peak UI exhaustion rate in the 1981-82 recession did not occur until August 1983, nine months after the low point of the recession, which occurred in November 1982. The chart also shows a disturbing long term trend toward higher benefit exhaustion rates, even when the economy is growing. In the 1960s the percentage of claimants who exhausted regular UI ranged between 18 percent and 30 percent of all the workers who filed a successful claim for benefits. Even in the midst of a long economic boom in the late 1990s, the UI exhaustion rate never fell this low. The long-term rise in the UI exhaustion rate mirrors the rise in long-duration unemployment spells. Chart 3 shows BLS estimates of the percentage of unemployed workers who have been jobless for more than 6 months. This percentage typically rises during and immediately after recessions and then declines in later stages of every economic expansion. However, the percentage of the unemployed who suffer 6 or more months of joblessness has been rising in successive recessions and business-cycle expansions, indicating that long-term unemployment has become a progressively worse problem over time.

### **International comparisons**

In spite of the long-term increase in the percentage of workers who suffer lengthy spells of unemployment, long-term unemployment remains relatively low in the U.S. compared with other industrialized countries. One reason might be the comparatively modest level of income protection offered under our UI system. When U.S. workers initially qualify for UI benefits their level of income protection does not fall much below replacement rates offered in other rich industrialized countries (see Chart 4). During the first 6 months after losing a job, the OECD finds that laid-off American workers receive UI benefits that replace about 60% of the after-tax value of their previous earnings. This is not far below the replacement rate offered in most other OECD countries.

The potential duration of U.S. benefits is substantially lower than the average in other industrialized countries, however. Chart 5 shows the maximum duration of unemployment benefits available in 21 OECD countries. The United States and United Kingdom rank at the bottom of the chart, providing just 6 months of regular UI benefits to laid-off workers. The special Extended Unemployment Compensation (EUC) and Extended Benefit (EB) programs make extra benefits available in this recession. Even when these temporary benefits are included, however, the United States only ranks in the middle of the industrialized countries listed in the chart.

When special unemployment programs are not in effect, U.S. workers cannot expect to receive UI benefits for more than 6 months. The result is that income protection against long-term unemployment is very modest in comparison with the protection available in other rich countries. Chart 6 shows estimates by the OECD of earnings replacement rates for workers who are unemployed for 60 months, 10 times the usual duration of UI benefits in the U.S. Among the 21 countries in the chart, only Greece and Italy offer less protection against very long-term joblessness. If laid-off U.S. workers have assets that make them ineligible to receive public assistance benefits, the income protection available to U.S. workers is even more meager than indicated in the chart. Without public assistance, the income protection available to long-term unemployed workers would replace just 6% of their net income before they were laid off. Nearly all of this protection is provided through UI.

The relatively short duration of U.S. unemployment benefits certainly contributes to laid-off workers' incentive to find a job. By the standards of most industrialized countries, typical unemployment spells in the United States are comparatively brief. In the middle of this decade, when most industrialized countries were growing, less than 1% of the U.S. labor force had been unemployed for longer than a year. In about a third of industrialized countries more than 2% of the labor force had been jobless for more than a year. In many, though not all, of those countries one factor contributing to high rates of long-term joblessness was the generosity of income protection against unemployment.

### **Income protection and economic stimulus in a deep recession**

The UI system serves two crucial functions. First, it provides workers with essential income protection when they are temporarily unemployed as a result of a layoff. Second, by helping unemployed workers maintain their consumption during recessions, UI gives the national economy an important stimulus in periods when overall unemployment is high or rising.

On both humanitarian and economic grounds it makes sense to provide longer-duration benefits to laid-off workers when the unemployment rate is high. Because unemployed workers usually need more time to find work in weak job markets, there is a compelling equity argument for offering insurance over longer spells of job search. In addition, the counter-cyclical effectiveness of unemployment compensation is reduced when a large percentage of laid-off workers is dropped from the rolls as a result of benefit exhaustion. For obvious reasons, workers are more likely to exhaust their regular unemployment benefits when the jobless rate is high (Chart 2). If no extensions of unemployment compensation were available, the percentage of unemployed who collect benefits would shrink as the length of a recession extends beyond the maximum eligibility period.

The EB program was designed to automatically extend the potential duration of UI benefits in recessions. When a state's unemployment rate is high, jobless workers are supposed to qualify for unemployment compensation beyond the usual 26 weeks of benefits. The program provides an additional 13 or 20 weeks of compensation payments for workers in states where the unemployment rate is higher than a threshold or "trigger" rate. In an ordinary recession, half the cost is paid out of a federal government unemployment trust fund and half is paid by states where the program triggers on. In the two decades leading up to the current recession, however, the EB program has rarely if ever triggered on in most states, even when the local and national unemployment rates are high. For

example, in June 2003 when the U.S. unemployment rate reached a post-recession peak, Extended Benefits were available in only 3 out of 50 states – Alaska, Oregon, and Washington. While the local unemployment rate was exceptionally high in those states, it exceeded 6.7 percent in six other states, including California, Michigan, and Texas. The Michigan EB program triggered on (for five months) beginning in August 2003, but in no other state did Extended Benefits become available during or after the 2001 recession. Before this recession, Extended Benefits were last available in California in July 1983. California’s unemployment rate exceeded 8 percent in 45 of the 266 months after July 1983. In none of those months were California’s unemployed eligible for compensation under its EB program. Before the current recession, the EB program had failed to “trigger on” in 33 states during any month after the 1981-83 recession.

The major shortcomings of the EB program mean that Congress must pass special unemployment measures whenever the job market begins to weaken. In every recession since the late 1950s the Congress has enacted a federally funded extension of unemployment benefits in addition to whatever extension might be available under the EB program. The extension in 1975-1977 was particularly generous, providing unemployment claimants who exhausted both regular and extended benefits with up to 26 additional weeks of compensation (for a total benefit duration that could last up to 65 weeks). The special benefit extensions in 1982-1985, 1991-1994, and 2002-2004 were less generous but still provided extra federally-financed benefits that could extend a worker’s total eligibility period by up to six months. Special programs to extend the duration of unemployment benefits were in effect during all or parts of 14 out of the 31 years after 1975. Depending on a worker’s state of residence and the details of the federal supplemental program in effect, a worker might qualify for 6 to 39 weeks of additional unemployment compensation beyond the 26 weeks available under the regular state insurance program.

In measures passed in June 2008 and February 2009 Congress once again enacted legislation to provide the UI extensions that should automatically have been provided by the EB program. It established the temporary EUC program in July 2008. Depending on the state-level unemployment rate, a laid-off worker who exhausts the standard 26 weeks of regular benefits can collect EUC benefits for either 20 or 33 extra weeks, giving workers an entitlement of both regular and EUC benefits that may range between 46 and 59 weeks. By the middle of September 2009, 33 weeks of EUC benefits were available in 44 of the 50 states, and 20 weeks of EUC benefits were available in the other 6 states. The full cost of EUC benefits is paid by the federal government. Under current law, Congress has authorized EUC benefit payments through the first five months of 2010, although no unemployed workers can commence receiving a new “tier” of benefits after the end of this year. Workers can only complete the tier of benefits that has commenced before the start of next year.

In addition to creating the temporary EUC program Congress also offered generous incentives for state governments to change the “trigger” rules for the state-federal EB program. Under previous law, one-half the cost of EB was financed by states. Under temporary rules included in the February 2009 stimulus package, Congress authorized the federal government to pay for 100 percent of the cost for EB benefits paid in 2009 and the first few months of 2010. (Under some states’ rules, no unemployed workers can commence receiving a new “tier” of EB benefits after the federal government stops paying for 100% of the benefit costs. In those states, workers can only complete the tier of EB benefits that has commenced before the start of next year.) Because states do not have to pay for any of the benefit costs, they have an incentive to adopt a lower

unemployment rate threshold for triggering Extended Benefits. States that follow this strategy can make an additional 13 to 20 weeks of unemployment compensation benefits available to laid-off workers at no extra cost to employers in the state. Many states have acted to take advantage of this temporary federal incentive. In the middle of September 2009, 20 weeks of EB benefits were available in 28 of the 50 states, and 13 weeks of EB benefits were available in 10 other states. In 12 states, EB benefits were not available. In most though not all of those states, the local unemployment rate is below the national average rate.

The combination of EUC and EB benefits has extended the potential duration of UI benefits to an all-time high – 79 weeks. In states with lower unemployment rates and in which legislatures did not amend their EB rules to take advantage of generous federal funding, the potential benefit duration is substantially shorter than 79 weeks. The following table shows the distribution of potential benefit duration across the 50 states. (I assume that workers are eligible for a maximum of 26 weeks under regular state UI programs, though a couple of states allow slightly longer benefit durations for some workers.)

**Potential UI Benefit Duration** (Effective September 13, 2009)

Maximum UI weeks available	79	72	59	46
Number of states	28	10	6	6

In all but 6 states, laid off workers are eligible for at least 13½ months of benefits. In 28 states, including 9 of the 10 with the largest populations, benefits are available for a little more than 18 months.

The availability of longer duration UI benefits has reduced the hardship faced by laid-off workers. It has also helped sustain their consumption when family finances are under severe strain. When the economy is growing strongly and recessions are only a distant memory, unemployment benefits represent only about 0.3% of personal disposable income. When wages and other sources of private income plummet as the result of a recession, unemployment benefits become much more important. In serious recessions, unemployment benefits may represent more than 1% of disposable income. The goal of the program of course is to partially replace wages lost as a result of layoffs. Chart 7 shows the cyclical surge and shrinkage of UI benefit payments measured as a percentage of the wages paid in the same month. Part of the cyclical movement occurs because total wage payments shrink in recessions, but most is the result of soaring UI benefit rolls when layoffs rise.

In the worst recessions, part of the increase in UI spending is the result of a policy choice by Congress and the President. By temporarily extending the potential duration of UI payments above 26 weeks policymakers reduce the fraction of laid-off workers who run out of UI benefits and increase the percentage of the unemployed population that has enough income to pay its bills.

Is it plausible that 100% of UI benefits are immediately spent to support consumption? Probably not. Some of the unemployed have savings, and others have sources of income besides their wage earnings. Many have access to credit with which to pay some of their bills. Some of these workers would be able to maintain all of their pre-layoff consumption, even if they did not collect an unemployment check. Nonetheless, UI recipients are typically drawn from the lower ranks of the income distribution, and so they have less savings and access to credit than average. Many are severely credit constrained, and the spending constraints they face grow more restrictive

the longer their unemployment lasts. Nearly all of the benefit expansions that Congress makes available during recessions take the form of extensions in the duration of UI benefits. Thus, benefit expansions are focused on the workers who are most likely to have exhausted their savings and used up their access to commercial credit. For these workers benefit extensions substantially increase the ability and willingness to spend on current consumption. Even if UI recipients spend less than 100% of benefits on immediate consumption, they are likely to spend a large percentage of any benefit increase that takes the form of longer benefit entitlement. Compared with other population groups, the long-term unemployed almost certainly will spend a larger percentage of a benefit hike or tax cut.

### *Adverse incentive effects*

While UI is an essential component of overall income protection, most people recognize that it creates adverse incentives for recipients. Because the UI payment replaces a percentage of the earnings workers lose as a result of unemployment, it reduces the pressure on them to accept another job. This is advantageous both to the worker and the wider economy when it improves a worker's capacity to reject bad jobs offers and find better ones. By improving the quality of matches between unemployed workers and job openings, a basic UI program can improve the average productivity of the workforce. This function of UI is especially important for workers who have extensive skills and experience. Their special expertise would go to waste if they accepted jobs where their skills have little use. UI also creates important incentive problems, however. It allows workers to postpone serious search for a new job, and it encourages some of the unemployed to reject good job offers even when they are unlikely to obtain better ones. In these cases, taxpayers are paying for additional UI payments to subsidize jobless workers who are not productively engaged in finding a new job. When weighing the welfare costs of these adverse effects, however, we should take into account the substantial welfare value of the income protection provided by UI. Air bags and seat belts reduce the adverse consequences of automobile accidents and thereby reduce drivers' incentive to drive safely. We nonetheless believe safety equipment is worthwhile because we are confident its value in protecting life and limb greatly exceeds the extra cost flowing from small increases in reckless driving.

There are some partial solutions to UI's incentive problems, and the U.S. unemployment system uses most of them. We can limit UI benefits to a carefully restricted population. We can offer insurance payments that replace substantially less than 100% of worker's lost earnings. We can restrict benefits to a limited period of time after layoffs. We can require workers to show evidence of purposeful job search. All industrial countries, including the United States, use one or more of these strategies to reduce the adverse incentives created by UI. Whether the balance of these program features in the U.S. system produces an optimal tradeoff between good income protection and sound incentives is an open question. Clearly, the United States has struck a different balance between income protection and job-finding incentives compared with the balance preferred in most other rich countries. By providing smaller and shorter-lasting benefits, our system encourages unemployed workers to find jobs quickly. Even though long-duration unemployment has become more common in the United States, it is still much less prevalent than it is in many countries that offer more generous income protection to the unemployed.



By providing longer duration benefits in a recession, benefit expansions like the EUC and EB programs can worsen the adverse incentives that are already built into unemployment insurance. How big a concern should this be? Given the current trend in unemployment and job creation, I do not think it is a major concern. Of the 14.9 million Americans who said they were unemployed and looking for work in August 2009, only about 60% were collecting any kind of unemployment insurance benefit. This means that 40% of job seekers were not affected by any of the adverse search incentives created by UI. Indeed, if the UI system was creating adverse incentives for the 60% of the unemployed who were collecting benefits, the 40% who did not collect benefits almost certainly found it easier to land a job. They faced less intense competition in finding a new job than would have been the case if fewer job seekers had been collecting a UI check.

When unemployment is extremely high and the number of job seekers greatly exceeds the number of job openings I am not terribly concerned about the adverse incentives created by extensions in unemployment benefits. The significance of the adverse effects is small in comparison with the importance of maintaining or increasing consumer spending. There are few population groups in the country who are likely to spend as much out of \$1,000 in extra government transfers as workers who have been unemployed for 6 months or longer.

### **Policy recommendations**

Authorization for EUC and 100%-federally-funded EB benefits will expire for workers who exhaust their regular unemployment benefits after December 31, 2009. In view of this fact, the most urgent policy need is to extend the authorization for these programs until a later date. I expect that the unemployed will find it harder to land a job after December 31 than it was when the EUC program was authorized in the summer of 2008. The arguments for establishing the EUC program in 2008 and for extending the program in 2009 will be even more compelling next winter. The unemployment rate is likely to be substantially higher than it was in either 2008 or the winter of 2009. The same considerations suggest that it would be worthwhile to authorize continued federal funding for the recent expansions of the EB program. In my view, the EUC and modified EB programs should be authorized to provide benefits to new UI exhaustees until the end of the current fiscal year, September 30, 2010. Congress should consider trimming potential benefit durations only when the unemployed begin to find it easier to obtain new jobs. I am not a macroeconomic forecaster, so I cannot offer a prediction of when that will occur.

Some advocates for the unemployed propose that the current extensions of UI protection should be expanded still further. In states with exceptionally high unemployment, Congress might authorize a third tier of EUC benefits to provide an additional 13 weeks of protection. Before taking this step, Congress should carefully consider two painful tradeoffs. First is the provision of subsidies so that unemployed workers can continue to pay for the employer-provided health insurance they received before their layoffs. Second is the provision of extended UI protection to workers who lose their jobs late in the recession or in the early months of the hoped-for recovery.

In this recession unlike earlier recessions Congress authorized the provision of generous federal subsidies to help unemployed workers pay for health insurance premiums. The subsidy, which is limited to 9 months per worker, covers 65 percent of the cost to laid-off workers of continuing their coverage under their former employer's health insurance plan. Most working Americans receive health insurance through their employer or the employer of another wage earner

in the family. Employers typically pay for most of the premium costs of this insurance. When workers are laid off they lose the employer subsidy. The total, unsubsidized cost of health insurance is typically unaffordable for a jobless worker, around \$4,700 a year for single workers and \$12,700 for workers with a spouse and child dependents.<sup>1</sup> These amounts are 10 percent and 32 percent, respectively, of the average year-round wage of American workers. Because relatively few workers can afford to pay the full cost of these premiums after they are laid off, many laid-off workers lose their health insurance until they find another job where health insurance is offered as a fringe benefit.

For non-elderly, non-disabled Americans with incomes above a low-income threshold, inexpensive group health insurance is available only to employees who work for employers that provide health insurance and to the dependents of those employees. Some companies do not provide health insurance to their employees, so their employees do not lose health benefits when they lose their jobs. But for the workers who are provided health insurance through their jobs, the loss of employment typically causes a much bigger loss than the loss of wage income. It also causes the worker and his or her dependents to lose access to affordable health protection. By providing generous subsidies so these workers can continue their health insurance after they are laid off, Congress dramatically expanded the protection available to laid-off workers who lost good jobs. In my view, it would be more valuable to extend this protection than it would be to provide an additional 13 weeks of UI to workers who may already have collected benefits for 79 weeks. Even though I am sure many unemployed workers have declined the federal government's 65% insurance subsidy and chosen to give up their health coverage after being laid off, I am equally certain the subsidy is vital lifeline for some unemployed workers who face high medical bills. Either the worker or a dependent of the worker has a costly medical condition that makes good health insurance a necessity. For these workers, access to basic health insurance may be much more important than eligibility for a few extra weeks of unemployment benefits.

Members of Congress should also keep in mind a second trade-off. At some future date the temporary extensions in UI will be allowed to expire. When that occurs, workers who have begun to collect a "tier" of extended unemployment benefits will probably be allowed to complete that tier, but neither they nor other workers will be permitted to begin collecting any additional tier of benefits. For example, workers who have begun to collect regular state UI benefits will not be permitted to collect EUC or 100%-federally-funded EB benefits. Those workers will only be able to collect to the standard 26 weeks of regular UI benefits. Before extending current emergency UI programs beyond 79 weeks, we should carefully consider how much funding will be needed to treat unemployed workers equitably today and over the future course of the recession and recovery. A rough rule of thumb is that we should attempt to offer broadly similar levels of earnings insurance through UI in good and bad labor markets. That is, if a new layoff is likely to cause a worker to lose \$10,000 in wages in a strong job market but \$20,000 in a weak job market, we should adjust the duration of unemployment benefits so that a similar percentage of lost earnings is replaced in the two cases. (Newly laid off workers should expect larger earnings losses when jobs are hard to find, and unemployment lasts longer, than when jobs are easy to find.) Based on our experience in recent

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<sup>1</sup> Wayne Vroman (2009), "Unemployment Insurance in the American Recovery and Reinvestment Act (HR1)," Washington, D.C.: Urban Institute. <http://www.urban.org/publications/411851.html>

business cycles, the U.S. job market is likely to remain weak for a considerable period. It will be hard for workers to find jobs for many months and probably for a number of years. Unless we are fairly confident we have the resources and will to offer extended UI protection for several years, it may be inequitable to provide very long-duration benefits to laid off workers who happen to be unemployed today.

As noted earlier, the most urgent item with respect to UI is an extension beyond December 31, 2009, of authorization for a simple extension of EUC and 100%-federally-funded EB benefits. Without such an extension, many workers who have been laid off in the past few months will not be eligible to receive UI after they exhaust their regular UI benefits. They will experience unnecessary hardship, and many of them will cut their consumption spending, generating new problems for the economy. I think our experience in this recession points to a number of areas in which long-term reform of UI is needed. I will mention just three.

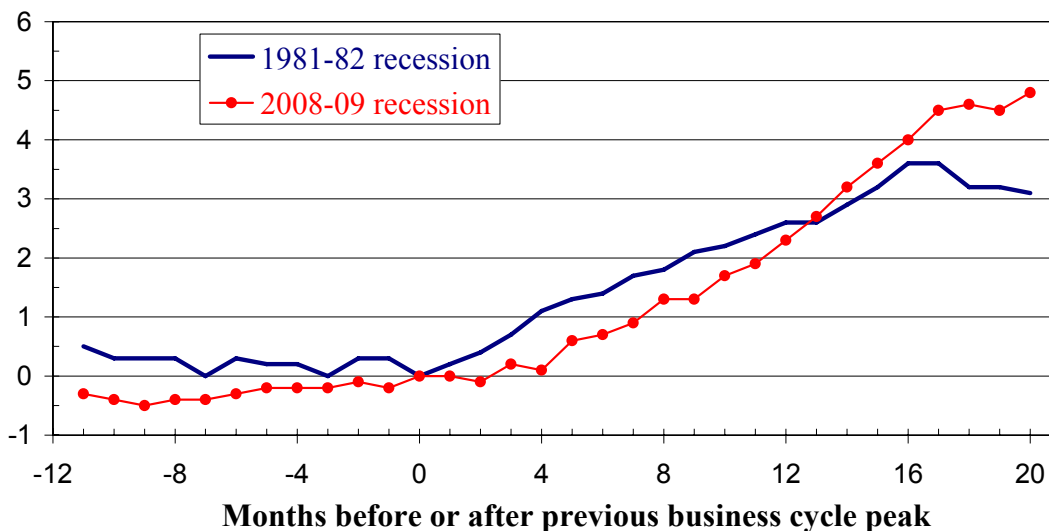
First, many states entered the recession with UI trust fund reserves that were plainly inadequate, notwithstanding the fact that the job market had been comparatively healthy for a number of years. By providing state trust funds with interest-free loans during the current recession, the federal government has unintentionally rewarded states for this short-sighted behavior. Sensible federal policy should encourage state legislatures to build up prudent trust fund reserves during economic expansions.

Second, the long-term trend toward longer unemployment spells and higher UI exhaustion rates signals a shift in the nature and severity of joblessness among some of the nation's unemployed. We should improve the job-finding and training services in the current system to deal with the problem. In addition, we should consider restructuring the income protection provided under UI.

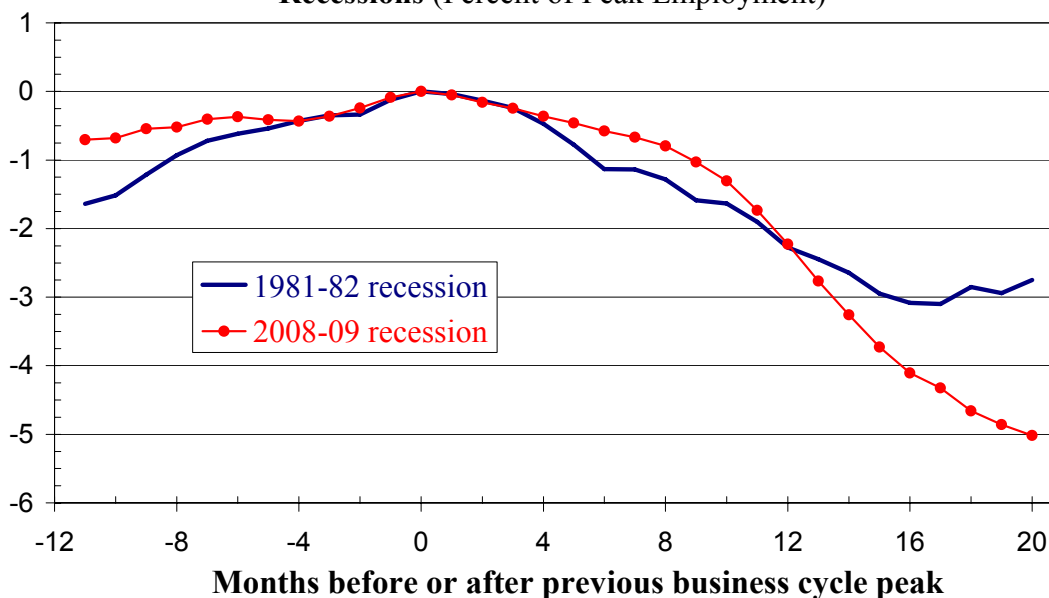
Finally, the basic system of financing UI is scandalously out of date. The federal unemployment tax is only assessed on the first \$7,000 of a worker's annual wages. This is equivalent to the annual earnings of a part-time, minimum-wage worker. In more than half of the states the tax base is less than \$10,000. For the country as a whole, unemployment insurance taxes are assessed on only about a quarter of wages. This system means that the maximum UI tax is assessed on the earnings of low-wage workers. In many states the unemployment tax is essentially a flat tax per person added to a company's payroll. It is hard to see why this tax structure is in the best interest of employers, of low- and average-wage workers, or of the nation as a whole. Congress should consider a basic overhaul of the financing system.

# Chart 1. Trends in Unemployment and Payroll Employment in Two Post-War Recessions

## Change in Unemployment Rate in 1981-82 and 2008-09 Recessions (Percentage Points)



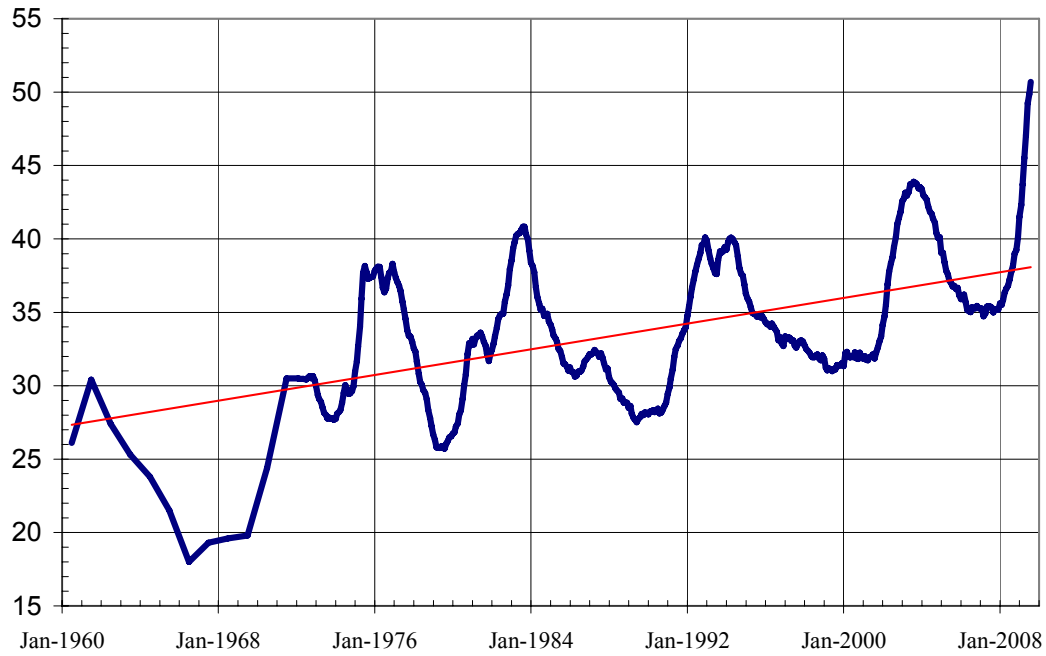
## Change in Payroll Employment in 1981-82 and 2008-09 Recessions (Percent of Peak Employment)



Source: Author's tabulations based on unemployment and payroll employment estimates from U.S. BLS, downloaded Sept. 10, 2009. Dating of recessions is that of the National Bureau of Economic Research.

**Chart 2. Unemployment Insurance Benefit Exhaustion Rate, 1960 - July 2006**

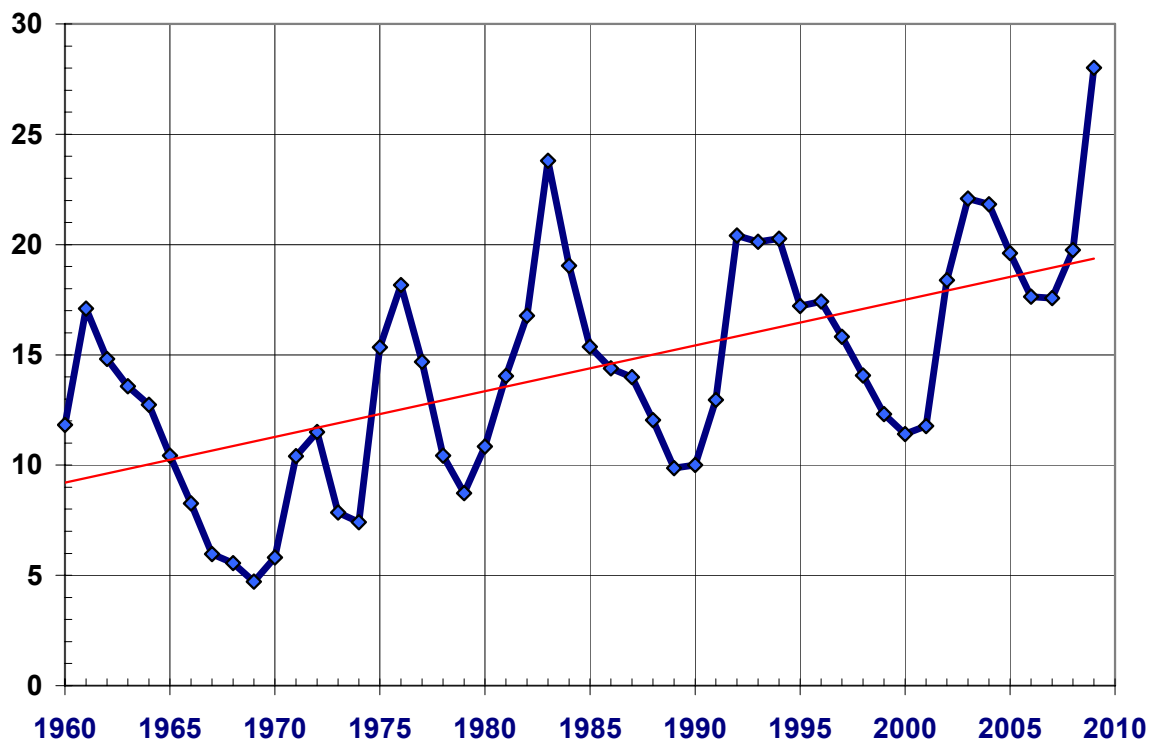
**Percent of beneficiaries who exhaust regular UI benefits**



*Source:* Author's tabulations of UI benefit exhaustion data from Department of Labor, Employment and Training Administration (downloaded Sep 11, 2009). Data are annual averages before 1972 and monthly thereafter.

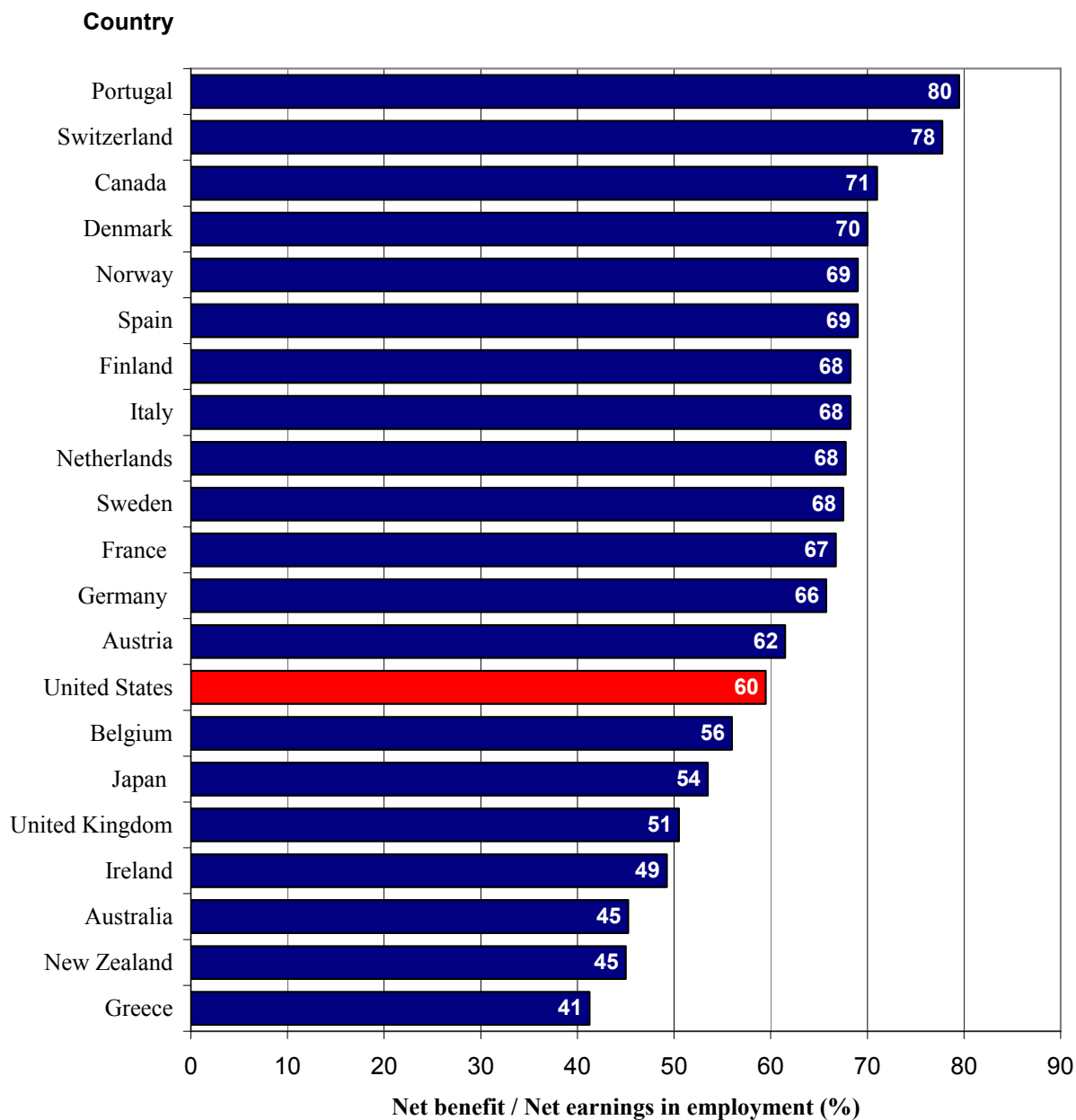
**Chart 3. Percent of the Unemployed Who Have Been Jobless for 27 or More Weeks, 1960 - August 2009**

Percent of all



Source: Author's tabulations of U.S. BLS data (downloaded Sept, 12, 2009).

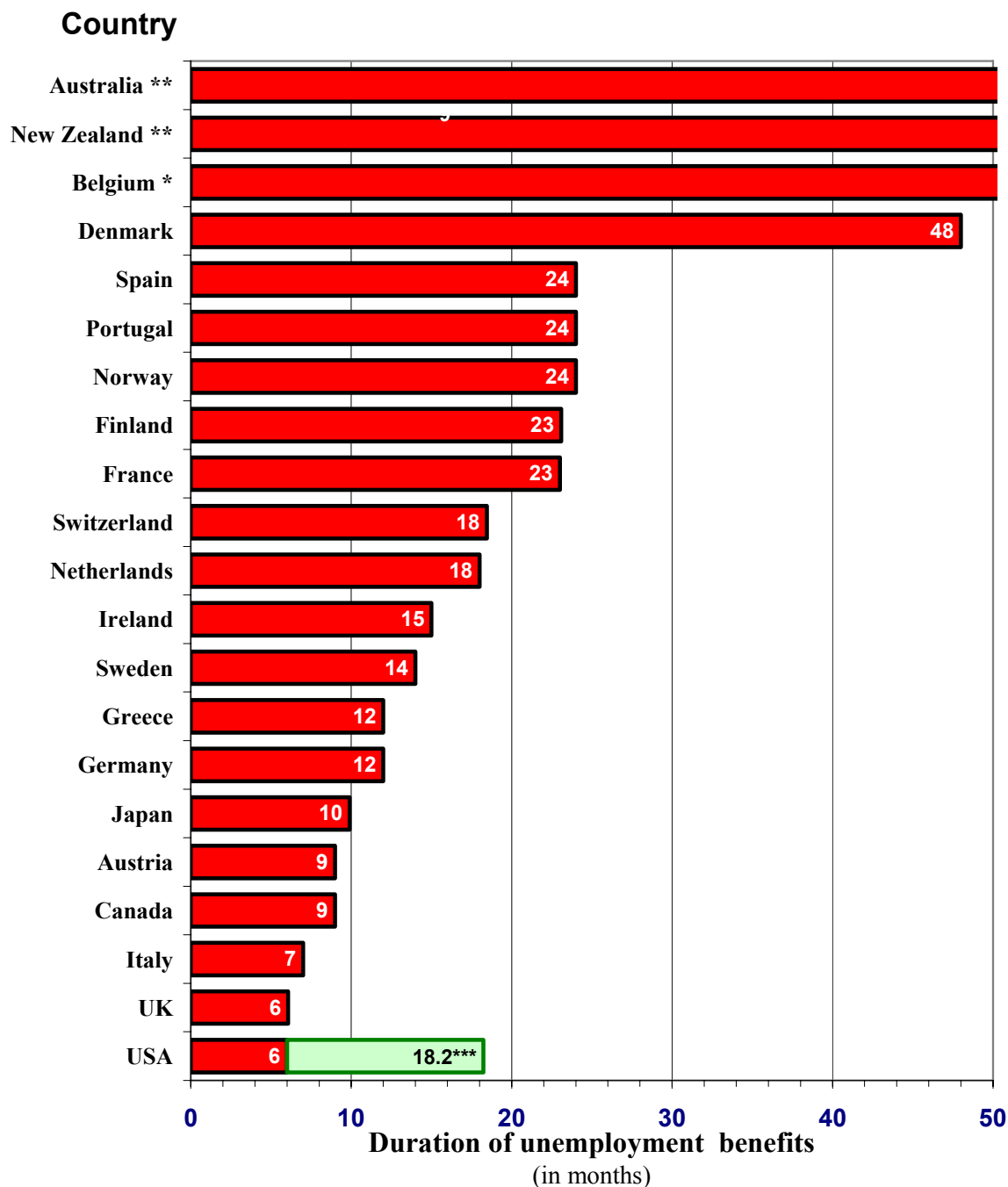
**Chart 4. Net Income Replacement in the Initial Period after Job Loss in 21 OECD Countries, 2005\***



\* Average replacement rate of workers earning the national average wage in four types of family situations: single and married, with and without children.

Source: OECD, *Benefits and Wages 2007: OECD Indicators* (Paris: OECD, 2007).

**Chart 5. Maximum Duration of Unemployment Insurance Benefits in 21 OECD Countries, 2005**



\* Belgium essentially provides unemployment benefits of indefinite duration.

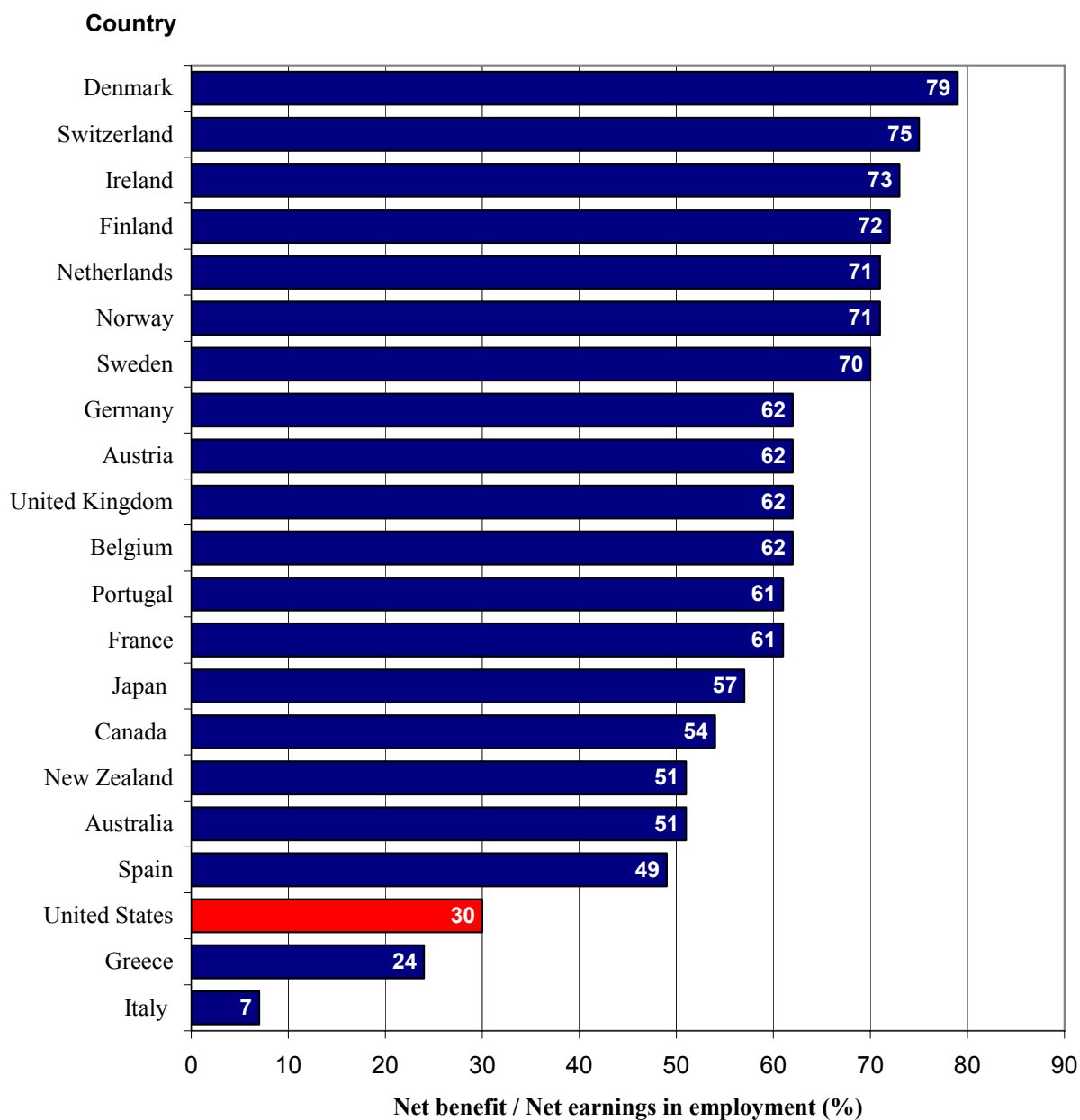
\*\* Australia and New Zealand offer only means-tested benefits. If the eligibility test continues to be met, unemployment benefits can last indefinitely.

\*\*\* Including maximum additional UI weeks temporarily made available in 2009 under the EUC and EB programs.

Source: OECD, *Benefits and Wages 2007: OECD Indicators* (Paris: OECD, 2007).



**Chart 6. Net Income Replacement in the First Five Years after Job Loss in 21 OECD Countries, 2005\***

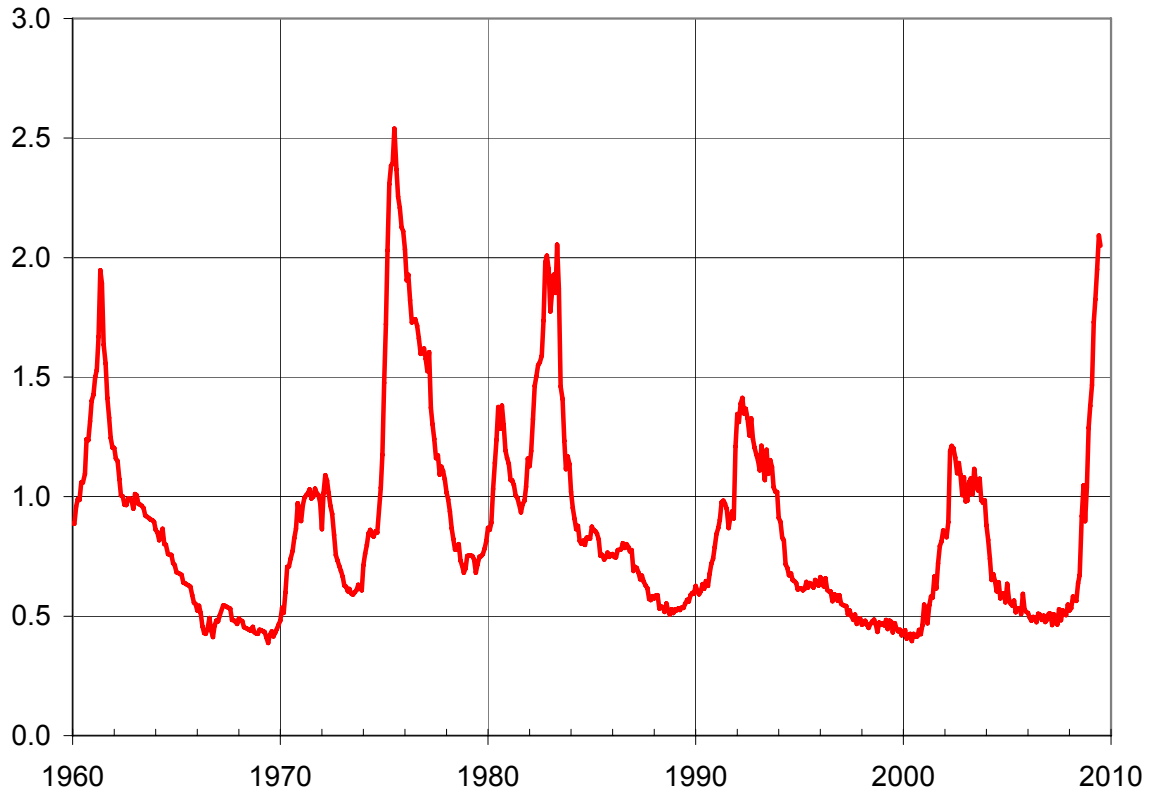


\* Average replacement rate of workers earning the national average wage in four types of family situations: single and married, with and without children.

Source: OECD, *Benefits and Wages 2007: OECD Indicators* (Paris: OECD, 2007).

**Chart 7. Government Unemployment Insurance Benefit Payments, January 1960 through July 2009**

Percent of total wage disbursements



Source: Author's tabulations of National Income and Product Accounts data, Table 2.6.