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Unleashing UI's Potential to Counter Recessions

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PROGRESSIVE POLICY INSTITUTE

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INTRODUCTION

Prospects for economic recovery are brightening as nearly 3 million Americans per day get their Covid shots.[1] But 18 million Americans still rely on unemployment insurance (UI) benefits, and many will continue to do so until the job market fully recovers and they can return to work.[2] Fortunately, President Biden's American Rescue Plan (ARP) Act, signed March 11, extended the benefits of 11.4 million jobless Americans until September 6.[3]

Having averted an immediate crisis, the White House and Congressional leaders should now work to transform UI benefits so that they automatically deliver vital aid throughout this downturn and those in the future.

Unfortunately, it appears they cannot count on bipartisan support. As they did in 2020, Senate Republicans fought to cut the pandemic extension's generosity, claiming it discourages people from taking jobs.[4] To keep GOP obstructionism from causing yet another harmful lapse in September, Senator Ron Wyden is pushing to automatically extend the expansion until the unemployment rate falls below a predetermined threshold.[5]

This makes sense from both a humanitarian and an economic perspective. Lawmakers should not only tie the generosity of benefits to the unemployment rate during this recession, they should do so permanently to insulate all future UI expansions from partisan wrangling in tough economic times.

In addition to preventing premature interruptions in benefits, this change would make future economic slumps less severe. Federal programs like UI that spend more in weak economies and less in strong ones are "automatic stabilizers" because they moderate swings in the business cycle without requiring Congressional action. Replacing unemployed workers' lost income through UI enables them to keep paying their bills, which helps to sustain demand across the entire economy.

U.S. policymakers also should work to modernize other elements of the UI system. As we saw last spring when unemployment surged, outdated computer systems hampered states' ability to get benefits to idled workers quickly. Congress wisely included $2 billion in ARP for updating UI systems. States should seize this opportunity to modernize their computer systems, and federal lawmakers should offer more resources if necessary.

In addition, Congress should develop a more equitable financing system for UI that fully pays for these expansions over the business cycle. The federal government and the states currently only apply their respective UI payroll taxes to workers' earnings below a maximum level, which is typically very low. As a result, many low earners pay exactly as much in UI taxes as well-off workers do despite receiving smaller benefits when they become unemployed. The federal government should fully pay for these expanded benefits across the business cycle by raising more revenue from incomes that UI does not tax today.

More specifically, this policy paper proposes that the Biden administration and Congress embrace the following changes in unemployment insurance:

- Permanently tie the share of lost wages replaced by UI benefits to the unemployment rate.
- Offer Extended Benefits for more weeks during severe recessions.
- Fund state IT modernization efforts and avoid duplication of efforts by developing UI administration technology for states at the federal level.
- Cover more jobseekers who are not currently eligible for UI by helping self-employed people save for gaps in work and expanding work-sharing programs.
- Pay for these reforms across the business cycle by taxing higher incomes than the program currently does.

Adopting these complementary sets of reforms – pegging UI benefits to the unemployment rate and modernizing the way benefits are delivered and financed – would create a stronger safety net for laid-off workers and help temper economic contractions.

BACKGROUND: TECHNOLOGICAL AND POLITICAL FAILURES UNDERMINE RECENT UI EXPANSIONS

UI is a partnership between the federal government and the states (plus Washington, D.C., Puerto Rico, and the Virgin Islands) that pays cash benefits to workers who lose their jobs through no fault of their own. Usually not qualified for UI are self-employed workers, people who are not seeking full-time jobs, and jobseekers with no work history. Although programs vary greatly between states, the average eligible beneficiary draws benefits equivalent to roughly half of their former average wage for up to 26 weeks.[6] The Extended Benefits program, created in 1970, extends that duration by 13-20 more weeks when the unemployment rate rises above "trigger" thresholds.

Although Extended Benefits make UI responsive to increases in the unemployment rate, lawmakers routinely expand benefits further during downturns. For example, during the Great Recession, beneficiaries could draw their normal benefits for 53 more weeks than usual before extended benefits kicked in. Amid the Covid recession, Congress has so far lengthened benefit duration by 49 weeks before a beneficiary receives Extended Benefits, and has expanded eligibility for UI through a program called Pandemic Unemployment Assistance.[8]

Congress also wanted UI to replace 100 percent of each beneficiary's lost wages during the pandemic. However, outdated state computer systems proved incapable of calculating and delivering benefits to workers swiftly. As a result, Congress instead raised benefits by $600/week for all workers through the Federal Pandemic Unemployment Compensation program, which made up the difference between the average UI benefit and the median worker's lost weekly earnings. Because pandemic-related job losses have been greatest among low-income workers, the increased benefits replaced 145 percent of the median actual beneficiary's lost pay.[9]

Republicans let the $600/week increase lapse last July after Senate Minority Leader Mitch McConnell called it a "crazy policy that is paying people more to remain unemployed than they would earn if they went back to work."[10] However, multiple studies showed there were too few jobs available for the increase to have any impact on employment.[11]

Congress finally passed another aid bill in December that increased all UI benefits by $300/week, which moves the total average UI benefit closer to the actual median beneficiary's lost wage.[12] The bill also extended the expansion of benefit duration and eligibility, but President Trump waited until after both had lapsed to sign the bill. States struggled to implement this last-minute extension quickly, and failed to pay 38 percent of the benefits they owed unemployed people during the first four weeks of January as a result.[13]

UI BENEFITS SHOULD AUTOMATICALLY ADJUST TO THE BUSINESS CYCLE

Rather than haggle over benefit levels every time the economy turns upwards or downwards, Congress should peg them to unemployment rates. Here is how this system could work: states would set their "standard" UI wage replacement rates to at least 50 percent. That rate would rise during recessions if the three-month running average of the state's unemployment rate surpasses 5 percent and is at least 1 percentage point higher than the average unemployment rate's lowest level over the prior 12 months, a trigger similar in structure to the Sahm Rule.[14] For the remainder of the recession, the program would automatically set its replacement rate equal to its standard rate plus 10 times the amount by which its average unemployment rate exceeds the threshold the state used to activate the increase.

For example, if the lowest three-month running average of a state's unemployment rate over the prior year was 6 percent, the state's UI program would increase benefits if that average unemployment rate rose above 7 percent. If it rose to 9.5 percent (2.5 percentage points above the 7 percent threshold), the program would set its replacement rate equal to 25 percentage points more than the standard rate, making benefits replace 75 percent of each worker's prior income. The replacement rate increase would fully phase out when the average unemployment rate returned to 7 percent.

To avoid paying out benefits that are greater than the wages workers expect to earn at their next job, the replacement rate should not exceed 100 percent. The elevated benefit should also expire automatically after five years, even if the unemployment rate has not fallen below the trigger threshold, to prevent benefits from remaining elevated when a state undergoes a structural change in its labor market that increases the "normal" unemployment rate.

PPI roughly estimates that this policy would have added $195 billion to the cost of normal UI benefits during the Great Recession (which is a better point of comparison for future downturns than the pandemic recession because of the unique impact that social distancing practices have on the economy).[15, 16, 17] The federal government should fully finance the benefit increase because it has a better ability to borrow money during recessions than states do.

Policymakers should also set a minimum and a maximum dollar amount for benefits, just as states do today, and index them to wage growth. Without a minimum benefit, a low-wage worker may be unable to survive on a UI benefit worth as little as half their already-meager income. Conversely, the federal government should not pay $25,000/month in benefits to someone who lost a $600,000 annual salary. The benefit cap should adjust automatically alongside the replacement rate, so that someone receiving the maximum benefit when the replacement rate is 50 percent still gets an increase if the replacement rate rises.

In addition to growing larger, benefits ought to last longer during downturns. Congress' routine benefit expansions show that Extended Benefits do not last long enough to adequately stabilize the economy during deep recessions. Further, states do not activate Extended Benefits as often as jobseekers need them. Some Extended Benefits triggers are optional for states to use, and many states pinch pennies by avoiding triggers that extend benefits frequently and for longer durations than mandatory triggers do.[18] For example, just 17 states use a trigger that can extend Extended Benefits from 13 to 20 weeks when the unemployment rate surpasses 8 percent.[19] Additionally, some triggers use "look-back" provisions that only consider unemployment "high" if it is high relative to the last two years, which can cut Extended Benefits off prematurely during long recoveries when unemployment is still high but slowly falling.

Congress should put UI benefits on a firmer foundation by requiring states to pay up to 26 weeks of benefits in normal times. Lawmakers should then extend Extended Benefits by 14 more weeks when a state's unemployment rate passes 9 percent and 13 more weeks when unemployment passes 10 percent, as proposed in the Hamilton Project and Washington Center for Equitable Growth's *Recession Ready* report. While this framework would make UI a potent automatic stabilizer in most circumstances, lawmakers could also further extend benefits on a discretionary basis when justified by unusual circumstances such as slow recoveries. Lastly, the federal government should fully fund Extended Benefits to encourage states to use accommodative triggers and should prohibit states from using look-back provisions to shorten benefits. The authors of *Recession Ready* estimate similar changes to Extended

Benefits would cost roughly $11 billion during a year of "severe" recession like those of the Great Recession.[20]

UI'S TECHNOLOGICAL INFRASTRUCTURE MUST BE MODERNIZED

For states to adjust UI's size and duration quickly, they will need more flexible computer systems than they have today. In 2012, over 90 percent of state UI systems ran on antiquated hardware and coding languages such as COBOL, which few coders learn to use.[21] New Jersey was so desperate for COBOL coders early in the pandemic that Governor Phil Murphy called on his state to recruit them the same way it was recruiting essential healthcare workers to fight the pandemic itself.[22]

The states' archaic systems have struggled to keep up with the sudden deluge of claims during the pandemic. Initial UI claims skyrocketed from just 300,000/week at the end of 2019 to over 6 million/week in late March and early April 2020, nearly six times the prior high set in 1982.[23] Seven months later, all but three states still failed to meet federal benefit timeliness standards.[24] Delays worsened when states had to code last-minute federal benefit expansions into their systems.

Many state UI websites, portals, and applications are similarly antiquated, making UI confusing to use. So many unemployed people called states to ask questions about their benefits that West Virginia and New Hampshire called out their National Guards to answer phones.[25] States can improve their customer-facing IT by making their applications accessible on mobile devices, hiring and training enough IT staff, and following other recommendations offered last year by the Century Foundation, the National Employment Labor Project, and Philadelphia Legal Assistance.[26]

Some states have modernized parts of their computer systems by forming consortia, which create a central system that each member state can adapt to its own needs. Consortia are cost-effective because they keep states from duplicating efforts.[27] But some have been hampered by conflicting procurement and communication policies, uninvolved state IT offices, and differences of opinion about how to develop software. For example, a consortium between Idaho, Vermont, and North Dakota fell apart late last February over disagreements about the new system's quality and ownership of its intellectual property.[28] The GAO also says one state quit its leadership role in a consortium out of a concern that they would bear liability for any issues the core system caused in other states.[29]

Any modernization effort could take years and will require meaningful federal investment. In 2012, every state GAO studied said funding was a "major challenge" to modernizing their IT.[30] Fortunately, ARP made $2 billion available for "systemwide infrastructure investment and development" relating to fraud detection, benefit timeliness, and accessibility. States should use these new resources to modernize UI computer systems, and the federal government should make more money available if necessary. Alternatively, the federal government could help states modernize their systems by designing UI technology for states itself, as Senate Democrats recently proposed.[31] Doing so would achieve similar economies of scale to those of consortia without the need for states to independently coordinate their modernization projects.

UI BENEFITS SHOULD REPLACE MORE JOBSEEKERS' LOST INCOMES

In addition to more generous benefits, lawmakers should expand the universe of eligible workers. Many jobseekers do not qualify for UI during normal times – in 2018, eligibility issues kept 43 percent of unemployed people who lost jobs in the previous year from applying for UI.[32] Policymakers should replace the income losses of more idled people, including self-employed workers and workers who lose work hours.

Self-employed workers such as gig workers and contractors typically do not pay UI taxes or qualify for benefits because it is hard for states to determine if these workers lost their jobs through no fault of their own. Congress should allow self-employed workers to open savings accounts that let them defer their taxes while they save for periods of unemployment, as PPI proposed last year.[33]

Workers who lose hours instead of suffering layoffs also typically do not qualify for UI. An exception are workers at some companies that cut hours rather than staff, who can get prorated benefits through a UI program called "short-time compensation" or "work-sharing."[34] However, just 26 states have work-sharing programs, and they are often underutilized. Rhode Island's work-sharing program serves more workers than other programs do because the state proactively advertises it to employers.[35] To encourage work and support people who lose work hours, Congress should require states to implement and advertise work-sharing programs.

UI REFORMS SHOULD BE FINANCED THROUGH A FAIRER TAX CODE

Congress should cover the cost of these expansions across the business cycle, and ideally make UI more progressive in the process. Presently, both the states and the federal government levy UI payroll taxes on incomes up to a maximum level. The taxes are typically charged on employers, although employers pass much of the burden onto employees through reduced wages.[36] The revenues from each state's UI tax goes into its account in the federal Unemployment Trust Fund, which pays for normal UI benefits and half the cost of Extended Benefits. State UI taxes are "experience rated," meaning the taxes discourage unnecessary layoffs by tying a business' tax rate to the number of workers they laid off who drew public benefits.[37] Meanwhile, the federal UI tax pays for program administration, half the cost of Extended Benefits, and loans to states with insolvent trust fund accounts.

The federal tax is typically a .6 percent tax on just the first $7,000 of wages paid.[38] This structure is regressive because most workers have incomes above $7,000 and thus pay a flat $42/year even though benefits rise with income. Although state taxes must apply to at least that same wage base, many do not tax much higher incomes than the federal tax does and are therefore nearly as regressive.[39, 40] Further, those low state taxes do not adequately fund UI. Only 15 states, Washington D.C., and Puerto Rico kept their trust fund accounts solvent through the Great Recession, and some states used their insolvency to justify cutting benefits.[41]

Policymakers should fully cover the cost of UI across the business cycle in a more progressive way. One option is raising the $7,000 federal wage base, tying the upper limit of the wage base to wage growth, and lowering the tax rate. Many states would follow suit to keep their bases as large as the federal base, making both the federal and state taxes more progressive.

Lawmakers could also pay for these expansions by imposing a new surtax on higher incomes or adopting a progressive consumption tax.

CONCLUSION

Unemployed workers turn to UI during a difficult time in their life. They deserve a modern unemployment insurance system that provides quick and reliable income to sustain them and their families until they can find work.

When the next crisis hits, states should be ready to expand UI automatically, without waiting for Congress to debate and pass an aid bill. To make quick and targeted expansions possible, the federal government should help states overhaul UI's technical infrastructure. Lawmakers should then equitably finance these reforms across the business cycle by raising revenues from higher incomes than the federal government and states tax today.

Lawmakers should adopt these reforms soon or else they might never happen. If policymakers fail to upgrade the UI system before the next crisis hits, the response to that crisis will have the same shortcomings as the response to this one. Only by modernizing UI now will the program have time to fully prepare to fight the next recession from the moment it begins.

ABOUT THE CENTER FOR FUNDING AMERICA'S FUTURE

The PPI Center for Funding America's Future works to promote a fiscally responsible public investment agenda that fosters robust and inclusive economic growth. In 2019, the Center published a comprehensive budget blueprint containing more than 50 ambitious but practical proposals for strengthening public investments in the foundation of our economy, modernizing federal health and retirement programs to reflect an aging society, and transforming our tax code to reward work over wealth – all while putting the national debt on a downward trajectory. This Progressive Budget for Equitable Growth can be found online at bit.ly/PPIBudget.

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