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UNEMPLOYMENT INSURANCE

Trust Fund Reserves Inadequate



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The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

The Honorable Tom Lantos
Chairman, Subcommittee on
Employment and Housing
Committee on Government Operations
House of Representatives

The Honorable Thomas J. Downey
Chairman, Subcommittee on
Public Assistance and
Unemployment Compensation
Committee on Ways and Means
House of Representatives

We prepared this report as part of our basic legislative responsibility to provide information needed by the Congress. The report provides information on the financial adequacy of state Unemployment Insurance trust fund reserves and the impact of post-1980 federal policy changes on both the Unemployment Insurance system's financial condition and on benefit eligibility. We hope that you will find this report useful and informative.

Copies of this report are being sent to the appropriate Senate and House committees and subcommittees; the Director, Office of Management and Budget; the Secretary of Labor; and other interested parties.

for 
Lawrence H. Thompson
Assistant Comptroller General

Executive Summary

Purpose

Since the late 1960's, the balances in most states' Unemployment Insurance trust funds have failed to grow as rapidly as their potential liabilities. As a result, in recent years it has become more common for states to borrow from the federal government to pay benefits during recessions. This trend has eroded the long-standing presumption that the Unemployment Insurance system is to be self-financing, and has led to changes in federal law to encourage states to repay their loans promptly.

At the same time, although the portion of the work force that is covered by the system has grown substantially, the portion of the unemployed who receive Unemployment Insurance benefits has declined. Moreover, there is evidence that states which have been forced to borrow from the federal government have tended to reduce benefit eligibility as one method of reducing program costs. These trends raise questions concerning the adequacy of state trust fund reserves and the effect that inadequate reserves may have on future benefit eligibility. In particular, GAO examined (1) trends in state trust fund reserve balances and in federal trust fund loans, (2) projections of the effect future recessions are likely to have on state reserve balances and the need for additional state borrowing, and (3) the impact of recent federal policy changes on the system's financial condition and on benefit eligibility.

Background

The Unemployment Insurance system is a joint federal-state program that pays benefits to workers in system-covered employment. The system's primary objectives are to give workers temporary and partial insurance against income loss resulting from unemployment and to assist the countercyclical stabilization of the economy during recessions by maintaining workers' purchasing power. The Department of Labor's Unemployment Insurance Service oversees the system, but states have considerable discretion to set benefit levels, eligibility, and tax rates. The federal government taxes employer payrolls to fund program administration; state payroll taxes finance benefits.

The system's long-standing presumption of self-financing has been eroding since the mid-1970's, when the government began making major loans to states otherwise unable to meet benefit commitments. Although only three state funds had ever received loans before 1972, during 1982-83, states needed loans of over \$11.8 billion to pay benefits.

Results in Brief

The Unemployment Insurance system has inadequate reserves, and many state trust funds will likely be unable to pay benefits in a future recession without multibillion-dollar borrowing. The most commonly

accepted measure of fund adequacy relates reserves to the highest levels of past benefit payout. Judged by this measure, 39 states had adequate reserves in 1969, but only 2 had adequate reserves in 1986.

Economic projections suggest that Unemployment Insurance trust fund reserves will remain inadequate even under conditions of continued economic growth. These projections also show that if a recession were to occur in 1988, as many as 17 insolvent funds would have to borrow money to meet benefit commitments.

Because federal loans are available, benefit payments to claimants are not directly jeopardized by such borrowing. However, during the 1980's states often adjusted to such financial difficulties by restricting access to future benefits. Federal policies enacted during the early 1980's have increased the costs of insolvency to state trust funds, encouraging them to pay back federal loans promptly. However, they have not resulted in states accumulating reserves sufficient to withstand a recession without substantial federal borrowing. These policies have also contributed somewhat to the long-term downward trend in the percentage of the unemployed receiving benefits because, to improve solvency, many states cut benefit costs by reducing claimant eligibility. States may respond in a similar fashion in the future if the system is not changed.

GAO's Analysis

Trust Fund Reserves Inadequate

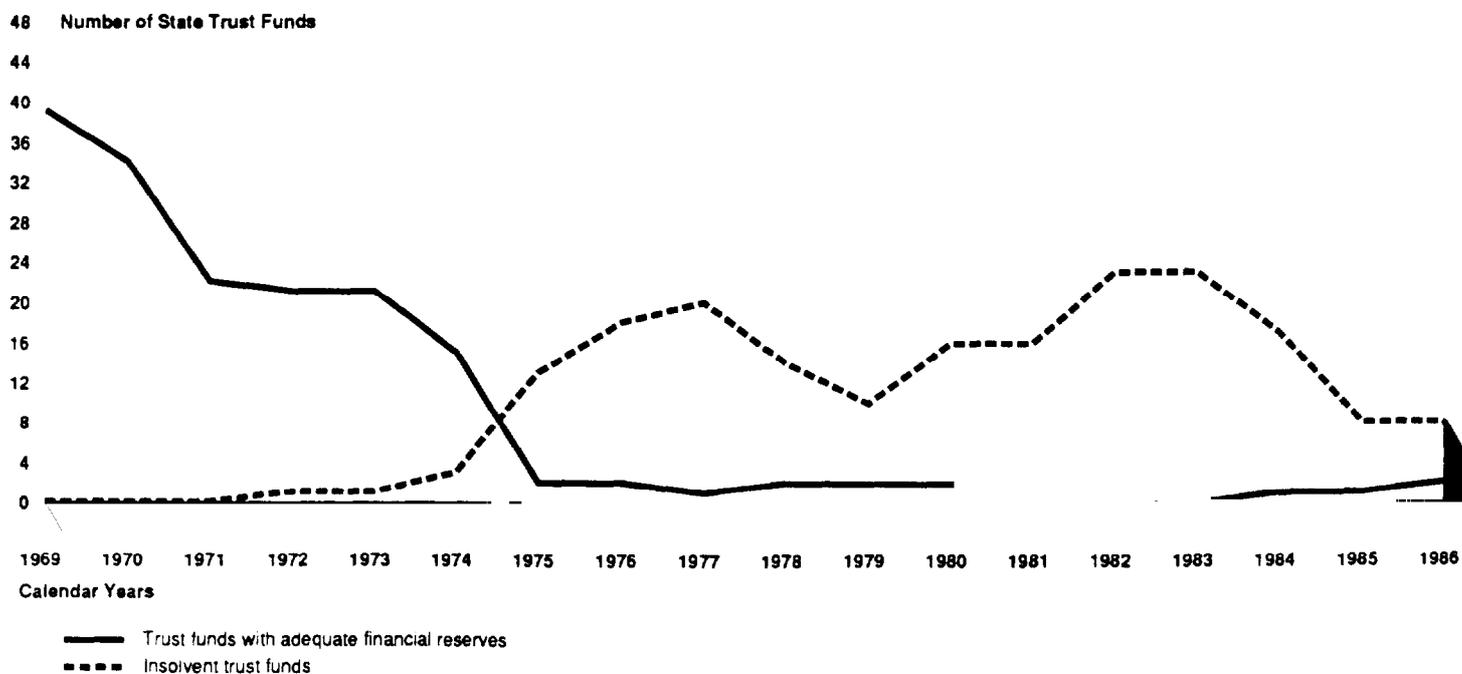
Although the level of reserves—\$19.4 billion in June 1987—are at an all-time high, they appear to be inadequate to finance the benefits that would have to be paid if a recession developed in the near future. A widely recognized indicator of reserve adequacy is the High Cost Multiple. It measures how long current reserves would last while paying benefits at the highest rate ever experienced. At the beginning of 1987, the overall system had a High Cost Multiple of .44, indicating that reserves would last about 5 months in a severe recession. By comparison, recent recessions have averaged 12 months, and in 1981 the Labor Department recommended 18 months as a voluntary state minimum (see p. 28).

State Borrowing a Problem Into the Mid-1980's

As reserves have become less adequate, more states have resorted to loans to continue paying benefits. In 1973, 21 trust funds had adequate reserves—equal to at least 18 months of recession-level benefits—and only 1 fund was insolvent (see fig. 1). By 1983, no state fund had adequate reserves and 23 trust funds were insolvent. Since then, improved economic conditions have allowed state funds to reduce their

indebtedness. Eight state funds remained insolvent at the beginning of 1987, but by January 1988, only one was insolvent. However, two of these repaid their loans by assuming state bond debt, and the other five still had inadequate reserves (see pp. 32-33).

Figure 1: Adequacy and Solvency of State UI Trust Funds (1969-86)



No Improvement in Reserve Adequacy Forecast

Although most loans have been repaid, reserve levels remain inadequate to cover recession-level benefit payments, and projections suggest that reserves are likely to remain inadequate. Using the January 1987 Labor Department projections of the Unemployment Insurance system, GAO determined that most state trust funds will not accumulate adequate reserves even if the current economic expansion continues into the 1990's. Although reserves are expected to grow about 60 percent from fiscal year 1987 through 1990, the aggregate High Cost Multiple will increase only slightly to a period average of 0.45 (see p. 37).

Proportion of Unemployed Receiving Benefits Declines

The average proportion of the unemployed receiving benefits during the 1980's has fallen by about 30 percent since the 1950's. In 1952, nearly 55 percent of unemployed civilian workers were receiving UI benefits; by

1986, only 32 percent received benefits. While much of the decline can probably be attributed to changes in the demographic composition of the labor force and other factors, states' responses to federal policies that increased the cost of trust fund insolvency have also contributed to the decline. To reduce benefit costs, states took actions to reduce the percentage of the unemployed receiving benefits. Between 1981 and 1987, 44 jurisdictions, 28 of which had borrowed federal funds, took actions that reduced benefit reciprocity (see p. 74).

Matters for Consideration by the Congress

The failure of most state Unemployment Insurance trust funds to maintain adequate reserves has eroded the UI system's self-financing feature and increased the potential for massive borrowing. If the Congress wishes to restore the self-financing feature and minimize the potential for significant state borrowing in recessions, it should require states to build adequate reserves during periods of low unemployment. By redesigning federal policies, the Congress could give states incentives to build adequate reserves rather than simply encouraging them to repay loans.

One option would be to establish a reserve standard for state UI trust funds, enforcing it with a mechanism analogous to the increased taxes currently levied on employers in states with delinquent trust fund loans. However, because current policy regarding federal lending to states has had the effect of encouraging an erosion of benefits, the Congress may wish to craft any measure to improve reserve adequacy in a manner that does not further erode benefit eligibility.

Agency Comments

The Department of Labor believes that any reserve standard is both unnecessary and infeasible. Although it acknowledges the current inadequate reserve levels of many state trust funds and the recessionary threat to many funds, Labor contends that the current system of individual state reserve policy in combination with federal loans is sufficient to handle future trust fund problems (see pp. 78-79).

GAO concludes that current federal policy has failed to encourage the buildup of adequate reserves. Trust fund insolvency during the last 15 years has been a chronic problem, which has been linked to reductions in benefit receipt. Because Labor formerly used a widely accepted standard as a simple voluntary guideline to assess trust fund reserve adequacy, it is clearly possible to use this or a more flexible alternative standard to require reserve accumulation.

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Abbreviations

CPS	Current Population Survey
FSC	Federal Supplemental Compensation
FUA	Federal Unemployment Account
FUT	Federal Unemployment Tax
IU	Insured Unemployed
IUR	Insured Unemployment Rate
LUR	Long-Term Unemployment Rate
NGA	National Governors' Association
PYE	Person Years to Employment
TU	Total Civilian Unemployed
TUR	Total Civilian Unemployment Rate
UI	Unemployment Insurance
UIS	Unemployment Insurance Service
UISIM	Unemployment Insurance Simulation Model
UTF	Unemployment Insurance Trust Fund

Introduction

The Unemployment Insurance (UI) system is the federal government's major program providing partial income maintenance assistance to the temporarily unemployed. The system's primary objectives are to give workers temporary and partial insurance against income loss resulting from unemployment and to assist in the countercyclical stabilization of the national economy during economic downturns by maintaining workers' purchasing power.

Benefits are paid to unemployed workers who (1) have worked long enough and earned sufficient wages to qualify under their state's minimum eligibility standards and (2) are ready, willing, and able to work. As of December 31, 1986, the UI trust funds of the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands maintained over \$15.4 billion in net reserves. The funds also paid about \$16.4 billion in benefits to more than 8.5 million unemployed workers, and raised about \$20.3 billion in employer taxes and interest on reserve balances.

The UI system shares several important attributes with other social insurance programs like Social Security and Medicare. They are all self-financed, and participants must have worked a minimum amount of time in covered employment in order to be eligible for benefits. However, UI differs from these other programs in that it is structured as a federal-state partnership, whereas the other programs are operated directly by the federal government. Each state operates its own UI program, levying and collecting its own payroll tax and, within certain limits, determining the level of benefits and the conditions for benefit eligibility. Each state also maintains its own trust fund account within the U.S. Treasury. As a result, tax rates, benefit levels, and trust fund balances vary across states, reflecting variations in program decisions and the economic fortunes of different states.

UI is financed primarily from earmarked payroll taxes. The tax proceeds are deposited in special trust fund accounts, and benefit payments are charged against these accounts. This arrangement assures that UI payroll tax revenue will not be diverted permanently to other government uses and that, except for temporary emergencies, benefit payments will not be funded from sources other than the unemployment payroll tax. The federal government holds all UI trust funds, meaning that all the tax receipts and outlays in the UI system are counted as federal receipts and outlays.

Because unemployment varies substantially during a business cycle, maintenance of the self-financing discipline requires that reserves be

accumulated during periods of rising economic activity in order to have sufficient funds to pay the increased benefit payments occurring during the periods of declining activity. During the first three decades of the programs' experience, states did a fairly good job of maintaining reserves at amounts sufficient to finance recession-level benefit payments. Beginning in the 1970's, however, the balances of many state trust funds began to shrink relative to potential commitments, and financial difficulties began to appear in states' accounts. To avoid disruptions in benefit payments while maintaining the self-financing principle, the program provides for the federal government to make loans to state funds that otherwise would become insolvent. The expectation was that these loans would be repaid from future payroll tax revenue when the economy recovered. Since the early 1970's, loans to state trust funds have been quite large, with individual state UI trust funds having borrowed over \$29.6 billion to pay unemployment benefits, \$11.8 billion during 1982-83 alone.

During the 1970's, federal loans to state trust funds were interest free, essentially providing a subsidy to debtor states (see ch. 4). In addition, because of severe unemployment, the Congress enacted legislation that permitted states to delay repayment without liability if they met certain conditions. The intent of these deferrals was to ease the financial burden on states in which loan repayment was scheduled while they still suffered very high benefit expenditures. However, these policies provided little incentive for states to repay loans and to rebuild trust fund reserves to adequate levels.

The Congress enacted policy changes during the 1980's, including the charging of interest on federal loans to state trust funds, which increased the states' incentive to repay loans. These policies helped to reduce the amount of outstanding loans but they did not address the problem of how to accumulate sufficient reserves to weather the next recession. The continued inadequate reserve accumulation raises serious questions about the system's financial health and jeopardizes prospects for the self-financing of future benefits.

In addition, there is a growing concern that the level of protection provided by the UI system is declining. In May 1986, the House Government Operations Committee's Subcommittee on Employment and Housing held hearings to explore the reasons for the declining proportion of the unemployed receiving benefits and the consequences of this decline. Many factors influence the decline in the proportion of the unemployed receiving benefits. The policies enacted by the Congress to encourage

the repayment of loans also resulted in states reducing benefits to many workers.

The rate of benefit recipiency remains low. In October 1987, the UI system paid benefits to one of the lowest proportions of the unemployed ever—about 1 out of every 4 unemployed workers. This raises concerns about the effectiveness of the UI system in achieving its primary objective of providing workers with income protection against the risk of unemployment.

Program Background

The UI system was established in 1935 as part of the Federal-State Employment Security Program, authorized under both the Social Security Act of 1935 (P.L. 74-271) and the Wagner-Peyser Act and later amended by the Federal Unemployment Tax Act of 1939. Since that time, the Congress has greatly expanded the system's coverage, provided for extended benefits during periods of high unemployment, increased the federal UI tax and taxable wage base, required the taxation of benefits as ordinary income, and levied interest on loans to indebted state trust funds (see table 1.1 and app. VIII for further information).

Structure

The UI system is a federal-state partnership. The UI Service, a part of the Department of Labor's Employment and Training Administration, provides guidance and technical assistance to programs in the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands. State and federal UI payroll tax receipts are deposited in their respective account in the Unemployment Insurance Trust Fund (UTF) and are used to pay for administrative expenses and benefit payments (see table 1.2).

Aside from certain federal standards that must be met for Labor Department approval, states have full autonomy in basic program operation to establish substantive program provisions.¹ Each state program is executed through state law by state employees, and each state establishes its own provisions regarding benefit qualification levels, the amount and duration of weekly benefits, benefit denial circumstances and penalties, and the state tax structure.

¹The federal government mandates 14 requirements for state program eligibility for federal administrative grants and 21 requirements for program-insured employers to receive the federal tax credit. These requirements include that states (1) use state UI tax revenue only for benefit payments and refunds for erroneous tax contributions and (2) reduce state employer taxes below the standard federal rate only if the reduction is based on the employer's past experience in laying off workers. (See app. VIII for a list of all federal UI standards.)

Table 1.1: Summary of Major Federal UI Legislation (1935-87)^a

Date of passage	Description
June 1933	The Wagner-Peyser Act established the national system of public employment offices, the U.S. Employment Service, within the Department of Labor.
August 1935	The Social Security Act established the UI system's framework, including the substantial state autonomy over state programs, the credit device for taxes paid under state UI laws that meet federal standards, and the federal financing of state administrative costs.
August 1939	The Unemployment Insurance Tax Act provided that the program tax base be limited to employees' first \$3,000 in annual earnings.
September 1954	Extended UI coverage to federal employees.
June 1958	Established the first temporary extended benefits program.
August 1970	Made major program changes, including a permanent 13-week federal-state shared cost extended benefits program; coverage extensions to employees in state hospitals, higher education institutions, most nonprofit organizations, and small employers; a provision to allow certain employers to pay UI benefits on a reimbursable basis; and an increase in the taxable wage base to \$4,200 per employee.
October 1976	Made major coverage expansions to state and local government employees, nonprofit elementary and secondary school employees, certain house workers, and many farm workers; increased federal UI tax; and increased the taxable wage base to \$6,000 per employee.
November 1978	Imposed the partial income taxation of UI benefits.
August 1981	Amended and tightened the triggering mechanism of the federal permanent extended benefits program; revised federal loan mechanism to include interest charges on loans to state trust funds.
September 1982	Established temporary Federal Supplemental Compensation (FSC) program, providing additional weeks of benefits; made some minor coverage changes; increased federal taxable wage base to \$7,000; increased federal UI tax rate; and increased the income taxation of UI benefits.
April 1983	Extended and modified the FSC program; established federal financial loan incentives to insolvent state programs.
October 1986	Imposed the full federal income taxation of UI benefit payments.
December 1987	Extended temporary 0.2-percent Federal Unemployment Tax for 3 years; funded several state UI demonstration projects.

^aSee appendix VIII for further information.

The Federal Unemployment Tax

The federal government levies a net 0.8-percent employer Federal Unemployment Tax (FUT) on each employee's first \$7,000 of annual earnings.² The FUT is collected by the Internal Revenue Service and deposited in the U.S. Treasury General Fund (see fig. 1.1). The FUT is then distributed among various accounts within the Unemployment

²The gross federal UI tax is 6.2 percent. Employers in states that have both Department of Labor-approved programs and no delinquent federal loans receive a 5.4-percent federal UI tax credit, making the net federal tax rate 0.8 percent. All 53 UI jurisdictions currently have federally approved programs.

Insurance Trust Fund to finance state and federal UI program administration and other activities (see table 1.2).

Figure 1.1: Flow Chart of FUT Tax Collection and Allocation

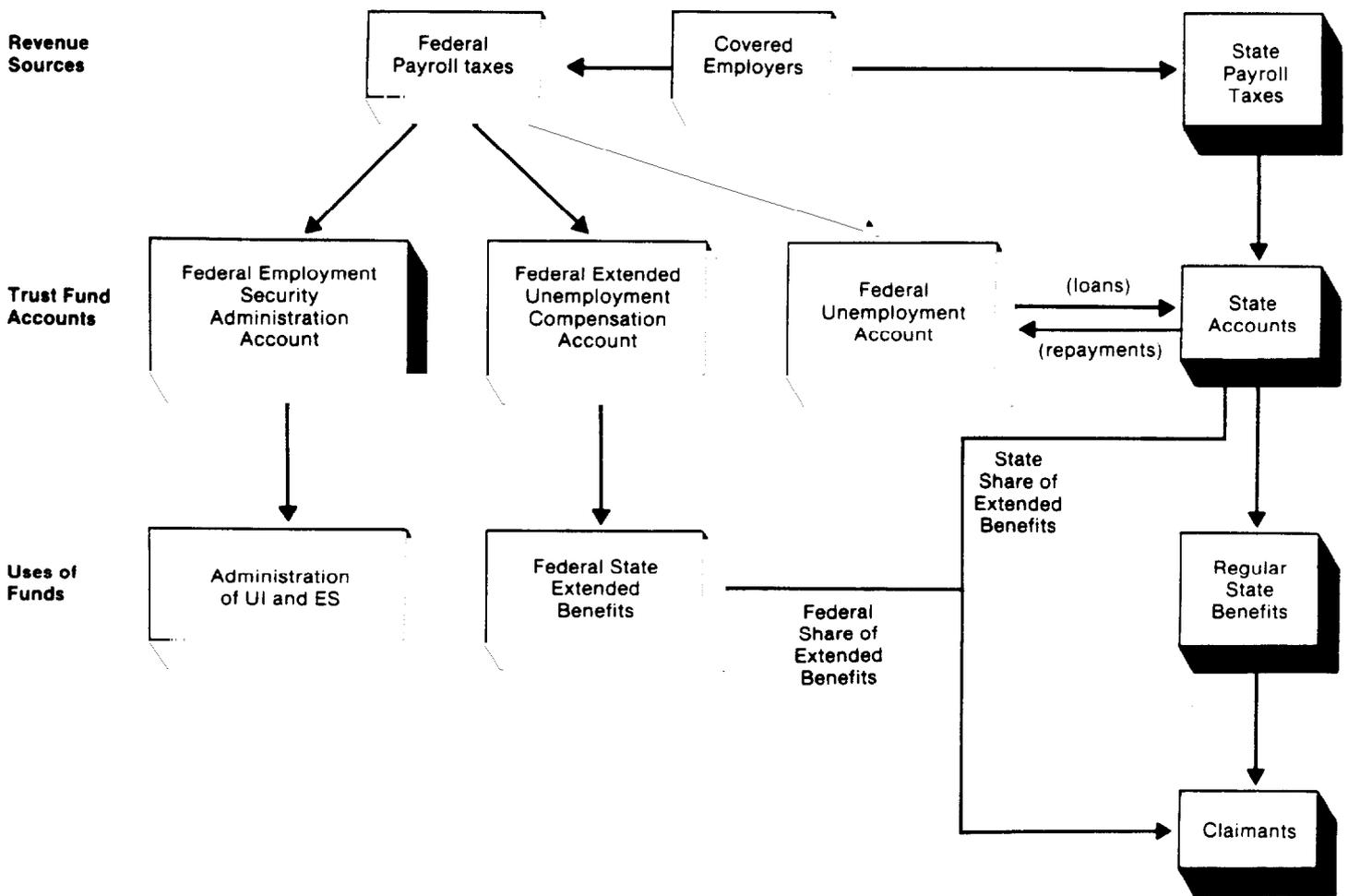


Table 1.2: Summary Description of Major UI Trust Funds and Federal Accounts

Name	Description
Unemployment Insurance Trust Fund (UTF)	This includes the individual trust fund benefit accounts of the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands, as well as the various federal accounts discussed below. It is the source of regular and extended UI benefit disbursements and administrative expenses. Revenues for this fund come from state and federal UI payroll tax receipts.
Individual state program accounts	These are the UTF accounts for the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands. Each state collects its UI tax revenue, which it then deposits in its account in the Unemployment Insurance Trust Fund.
Extended unemployment compensation account (EUCA)	This account finances the federal portion of the extended benefits program. The permanent extended benefits program provides up to 13 weeks of additional UI benefits on top of regular UI benefits to unemployed workers in qualified states. Extended benefit costs are shared on an equal basis between the federal government and the state.
Employment security administrative account (ESAA)	This account finances the administration of the state UI and Employment Service Programs.
Federal unemployment account (FUA)	This account provides loans to insolvent state trust funds.
Federal employees compensation account (FECA)	This account reimburses state trust fund benefit payments to federal civilian employees through the Unemployment Compensation Federal Employees Program (UCFE) and to ex-service members through the Unemployment Compensation Ex-Service Members Program (UCX).
Federal Unemployment Benefits Allowances Account	This account finances Trade Adjustment Assistance Benefits under the Trade Readjustment Assistance Act and the Redwood National Park Expansion Act. It is funded by an appropriation from the general fund.
Disaster Unemployment Account	This account finances benefits and loans under the Disaster Relief Act and is funded by an appropriation from the general fund. ^a

^aIn addition, the Railroad Unemployment Insurance Account pays UI benefits to railroad workers, the only occupational group covered under a separate UI system. This account is financed by railroad contributions and is administered by the Railroad Retirement Board.

State Unemployment Taxes

Employers pay state UI payroll taxes on at least the first \$7,000 of each employee's annual earnings.³ These taxes are collected and monitored for potential fraud or delinquency by the state UI agencies and are used to pay regular state benefits. Each state deposits these revenues into its trust fund account within the federal Unemployment Insurance Trust Fund.

States generally structure their UI taxes to include several tax rate schedules. The schedules often vary according to some measure of the state trust fund's balance, with the highest tax schedules generally applicable when state fund balances have fallen below a specified level.

³As of January 1987, Alaska, New Jersey, and Pennsylvania also levy a payroll tax on employees.

Within a tax schedule, an employer's tax rates will vary according to the firm's past experience in laying off workers. In 1986, such "experience-rated" tax rates in state laws ranged from 0 on some employers in 13 states to 8 percent or more of each worker's taxable wages employed by a firm in 11 states. Average state tax rates on taxable wages ranged from 1.1 percent in Florida to 5.4 percent in Michigan, with a national average of 2.8 percent.

Partly because of individual states' tax structure and partly because of a reported increased state sensitivity to UI tax rates, average 1987 UI taxes were lower in over 30 states compared to 1986 levels.⁴

Coverage

The UI system now covers nearly all employed wage and salary workers and the bulk of total civilian employment. Over 97 percent of all wage and salary employees were in the UI system in 1986, compared to 74 percent in 1950 (see fig. 1.2). The system covered about 88 percent of total civilian employment in 1986 compared to 56 percent in 1950.⁵ Most coverage expansion has occurred since 1970 and has been federally initiated. Major federal actions included extending coverage to many household workers; employees of many nonprofit organizations, farms, and small businesses, state, and local government, including state hospitals; and with certain exceptions, state higher education institutions. Table 1.1 provides a historical summary of the system's major legislative changes. States may insure employment not covered by federal standards, although most have not expanded coverage significantly beyond the federally mandated populations.

Eligibility Standards

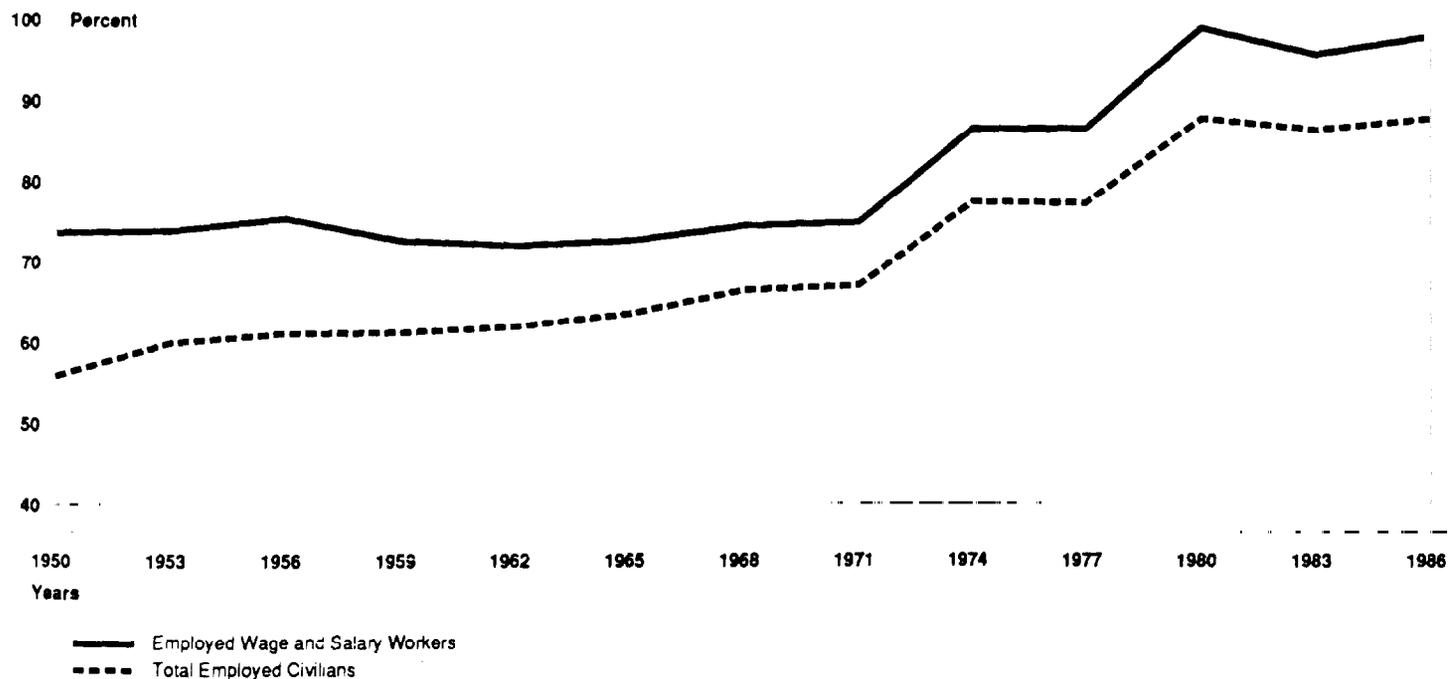
States have established a variety of methods for determining program benefit eligibility. However, the three factors common to most state eligibility provisions are:

- **Monetary standards:** States specify the minimum levels of recent employment (number of weeks or hours worked) and earnings needed by a claimant to qualify for benefits.

⁴The Wall Street Journal, December 29, 1987, p. 17.

⁵Total civilian employment is larger than employed wage and salary workers because it primarily includes the self-employed.

Figure 1.2: UI Covered Employment as a Percentage of Total Wage and Salary Employees and Total Civilian Employment, Selected Years (1950-86)



Employed wage and salary workers include only nonagricultural employees. before 1957. Program coverage was extended to many agricultural workers in 1976

- Availability for work: All state laws require that a claimant be available and able to work as a condition for benefit receipt.⁶
- Quit, job offer refusal, or misconduct benefit denials: States may deny benefits to claimants who are discharged for misconduct, quit work without good cause, or refuse suitable work or become unemployed as a result of a labor dispute.

Amount and Duration of Weekly Benefits

States generally compute weekly benefit payments as a percentage of the individual's average weekly earnings but impose a state-determined ceiling on these benefits. Maximum benefits typically vary between 50

⁶These qualifications are subject to federal standards that restrict benefit denial to otherwise eligible individuals. (See app. VIII.)

and 70 percent of the state's average weekly wage in covered employment. In 1987, maximum weekly benefits ranged from \$95 to \$330, and minimum weekly benefits ranged from \$5 to \$62 (see table 1.3).

Table 1.3: Maximum and Minimum State Weekly Benefits and Benefit Duration
(Jan. 1987)

Benefit	Highest	Lowest
Maximum state weekly benefit	\$330 ^a	\$95
Minimum state weekly benefit	\$62	\$5
Maximum regular benefit duration (number of weeks)	30 ^c	20
Minimum regular benefit duration (number of weeks)	30	1

^aMassachusetts' maximum weekly benefit amount ranges from \$220 to \$330 with dependent allowances.

^cIn Puerto Rico, benefits are extended to 32 weeks in certain industries, occupations, or establishments when special situations exist.

Most states set the length of UI benefit duration by the amount of earnings that the claimant has received during a defined base period.⁷ In 1987, minimum benefit durations ranged from 1 week in Wisconsin to 26 weeks in eight states. Only 10 states had a uniform period of benefit duration—they provide the same duration of benefits to all claimants. However, with the exception of Puerto Rico, all state programs provide up to at least 26 weeks of UI benefits.

Extended Benefits and Federal Supplemental Compensation

In 1970, the Congress enacted a permanent extended benefits program. This program provides 13 weeks of benefits to UI claimants in addition to the 26 weeks generally received under regular state programs. States pay extended benefits at the same rate as the claimant's weekly benefit amount under state law. However, extended benefits are financed equally by the federal Extended Unemployment Compensation Account and by state tax revenues.

Claimants are eligible to receive extended benefits if their state has triggered the extended benefits program into operation. This occurs when a state's 13-week insured unemployment rate (IUR) is 20 percent higher than its average weekly rate over the corresponding 13-week period

⁷A base period or year is the 4-quarter or 52-week period used for determining eligible earnings, weekly benefit amount, and benefit duration. Most states define the base year as the first four of the last five completed quarters before the unemployed worker claimed benefits.

during the last 2 years and is at least 5 percent.⁸ In addition, a state may optionally trigger the program when its weekly IUR reaches 6 percent.

During periods of high unemployment, the federal government has occasionally established temporary, completely federally funded programs paying additional weeks of benefits beyond those provided by the regular and extended benefit programs. The most recent temporary program was the 1982 Federal Supplemental Compensation Program, which in its original version provided up to 10 additional benefit weeks to claimants who had exhausted regular state benefits and any extended benefits to which they were entitled. This program was terminated in March 1985.

Program Loans

State trust funds that cannot finance their benefit payments may obtain loans from the Federal Unemployment Account. States that receive federal loans have between 22 and 34 months to repay them without penalty. Employers operating in states that fail to complete timely loan repayment are liable for automatic federal unemployment tax increases in the form of reduced federal tax credits. These “penalty taxes” essentially represent involuntary repayments of state loans and escalate with the duration of delinquency, although they cease upon full repayment of the loan. Between 1975 and 1979, the Congress permitted the waiver or deferral of penalty taxes for states that met certain tax structure criteria or actually repaid a portion of the loan. These deferrals expired in 1980.

In 1981, the Congress enacted legislation that requires debtor states to pay interest on all funds borrowed after March 31, 1982, if the state does not repay the loan during the same fiscal year as borrowed.⁹ Repaid loans are used to reduce outstanding general revenue advances to FUA and to make new loans to insolvent states.

The 1983 Social Security Amendments allowed states that had high insured unemployment rates or that approved legislation satisfying certain solvency conditions to defer their interest payments on UI loans for

⁸The IUR is the number of regular UI benefit claimants divided by the average number of people employed in jobs covered by the UI program in the first four of the last six completed calendar quarters.

⁹The interest rate charged on federal loans is equal to the rate the federal government paid on net state trust fund reserves—a weighted average of all long- and short-term federal debt—during the last quarter of the preceding calendar year. The loan interest rate is levied annually, not compounded, and is capped at 10 percent, while the rate on reserves is compounded and paid quarterly with no interest cap. As of December 31, 1987, the loan interest rate was 8.54 percent.

up to 4 years or to reduce the interest rate on their loans or both.¹⁰ Most of these incentives expired at the end of fiscal year 1985.

Objectives and Scope

In light of the heightened awareness of the federal deficit, the large amount of revenue transfers necessary to enable state trust funds to meet benefit obligations during the most recent recession, and the concern over the declining proportion of the unemployed receiving UI benefits, we sought to assess the current financial status of the UI system and identify the major policy issues it will likely face in the coming years. Specifically, our objectives were to assess

- trends in state trust fund reserve balances and in state trust fund borrowing,
- projections of the effect future recessions are likely to have on state reserve balances and the need for additional state borrowing, and
- the impact of recent federal policy changes on the system's financial condition and on benefit eligibility.

Methodology

We reviewed and analyzed the UI system's financial status since 1950, focusing on the period after 1970. Specifically, we analyzed financial information on the aggregate trust fund and the individual state trust funds. We examined commonly recognized measures of trust fund financial adequacy, like the High Cost Multiple (see ch. 2), and aspects of financial insolvency, like the magnitude of federal loans to state trust funds. Statistical data were compiled from the Department of Labor, Employment and Training Administration, Unemployment Insurance Service, Division of Actuarial Services, and the Bureau of Labor Statistics. We obtained other information from the individual state UI programs.

We examined the characteristics of both UI recipients and all unemployed workers using the March supplements to the Current Population Survey (CPS) for 1980 and 1986. The March CPS, conducted by the Bureau of the Census, obtains information concerning sources of income and work experience from the previous year.¹¹ This information allowed

¹⁰In qualifying for an interest deferral, a state defers its current interest by repaying it in equal payments over a 4-year period.

¹¹The CPS is a monthly survey conducted by the Bureau of the Census for the Bureau of Labor Statistics. It obtains the information on employment and unemployment that is used to compute the monthly unemployment rate. Each March the survey is expanded to obtain information on work experience and income from the previous year (see ch. 3 and app. V).

us to identify various economic and demographic characteristics of UI recipients.

We analyzed many aspects of the UI system, including its legislative history, structure, and function at both the federal and state levels. In our review, we made a comprehensive literature search of studies of the system. Our consultant, an expert on UI financing, developed a simulation model of the Massachusetts state trust fund to assess the fund's financial status under alternative economic conditions. We also used the Department of Labor's state UI trust fund model to assess the impact of changing economic conditions on the system's aggregate financial health. Appendixes providing additional information on various aspects of the UI system and on the trust fund model simulations are included at the end of this report.

Declining Reserve Adequacy and Increased Borrowing by State Trust Funds

The aggregate UI system and most individual state trust funds continue to have reserves that are inadequate to pay benefits in an economic downturn without significant federal borrowing. The number of state trust funds with adequate reserves—balances that meet or exceed generally recognized standards of financial reserve adequacy—has declined significantly since the late 1960's; today only a few funds have adequate reserves.

In the past, the Department of Labor has suggested that states build their account balances up to the level that would be sufficient to fund monthly benefits at the magnitudes experienced during severe recessions for at least 18 months. Although aggregate net balances have grown significantly since 1983, the June 1987 balance (\$19.4 billion) is equivalent to about a half a year's worth of recession-level benefit payments. The reserves of most state trust funds also remain inadequate. In 1969, 39 states had balances that met or exceeded the 18-month standard; by the end of 1986, only 2 states had such balances.

This decline in the adequacy of trust fund reserves foreshadowed the insolvency of many state programs. Since 1974, a growing number of state trust funds experienced periods of insolvency¹—that is, they required federal loans in order to have sufficient reserves to meet benefit payments. At the end of 1986, eight state trust funds were insolvent, although this number declined to one by the beginning of 1988. Several factors have contributed to the system's increased need for federal loans, including the high unemployment generated by three major recessions since 1970, the tendency in certain states for the growth in inflation-indexed benefit expenditures to exceed UI tax revenue growth, and unfunded increases in state benefit expenditures stemming from the 1970 establishment of a national extended benefits program.

Economic projections suggest little improvement in reserve adequacy over the next few years. Our analysis of Department of Labor UI trust fund projections, a National Governors' Association (NGA) report, and four alternative scenarios obtained from a simulation model of the trust fund in one relatively well-financed state indicates that net state trust fund reserves will not reach adequate levels during the next 4 or 5 years

¹In this report our characterization of state trust fund solvency refers to the level of that account's balance, net of federal loans, at the end of the calendar year. This is consistent with the general approach used by UI program actuaries in characterizing trust fund balances. In this context, whether a fund is solvent or insolvent has no direct bearing on whether UI benefit payments will continue as promised, since states with insolvent trust funds are permitted to borrow as necessary to meet benefit commitments.

even under conditions of continued economic growth. A recession any-time in the near future would increase insolvency significantly, with 17 state funds forecasted to require federal loans—greater than reserve balances—during fiscal year 1988 to continue benefit payments.

Long-Term Decline in Financial Adequacy

The federal-state UI system is one of the nation's major social insurance programs, exhibiting multibillion-dollar revenue and expenditure flows. Regular state benefit payments peaked in 1982 at about \$22.4 billion (see fig. 2.1).² In calendar year 1986, the system paid out over \$16.4 billion in benefits, of which \$16.0 billion was for regular state benefits and the remainder for other benefits.³ Fund revenues from state UI tax collections and earned interest have also grown steadily, reaching \$20.3 billion in 1986.⁴

Total state UI trust fund revenue generally grows during economic expansions and declines during recessions, while benefit payouts typically exhibit the reverse pattern. Net state trust fund cash flows will tend to be positive (revenues greater than benefit expenditures) during economic expansions and negative during recessions. Because of repeated recessions, annual net benefit outflows increased significantly during the 1970's and early 1980's. Consequently, aggregate net reserves drifted cyclically downward during these years (see fig. 2.2). The economic expansion begun in 1983 has reversed this trend, and aggregate net reserves increased to a record \$19.4 billion in June 1987. Despite this large size, current reserve levels appear to be inadequate when compared with the potential benefit payments in the event of a recession.

Measuring the Adequacy of Trust Fund Reserves

There is no universally accepted standard of UI trust fund reserve adequacy—the level of state trust fund reserves needed to meet current and future benefit demands. Trends in the most commonly used indicator of reserve adequacy, the High Cost Multiple, suggest, however, that the system's ability to pay benefits from available reserves has declined significantly during the postwar era, especially since 1970.

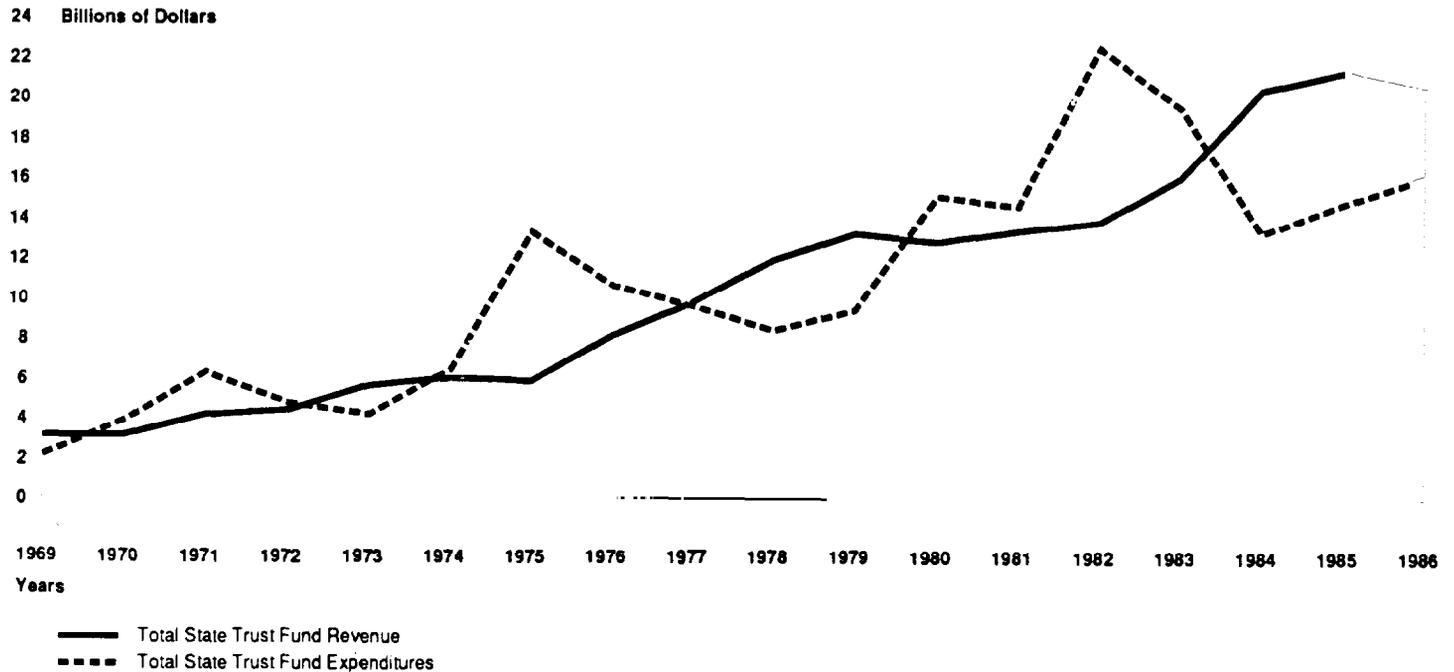
²This figure excludes the federal share of extended benefits and the benefits paid through temporary assistance programs but includes benefits paid by reimbursable employers.

³Other benefits include benefit payments by reimbursable employers. The \$400 million includes the federal share of extended benefits, and payments to federal employees and to ex-service members.

⁴This figure includes expenditures by reimbursable employers.

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Figure 2.1: Total Annual State Trust Fund Revenues and Benefit Expenditures (1969-86)



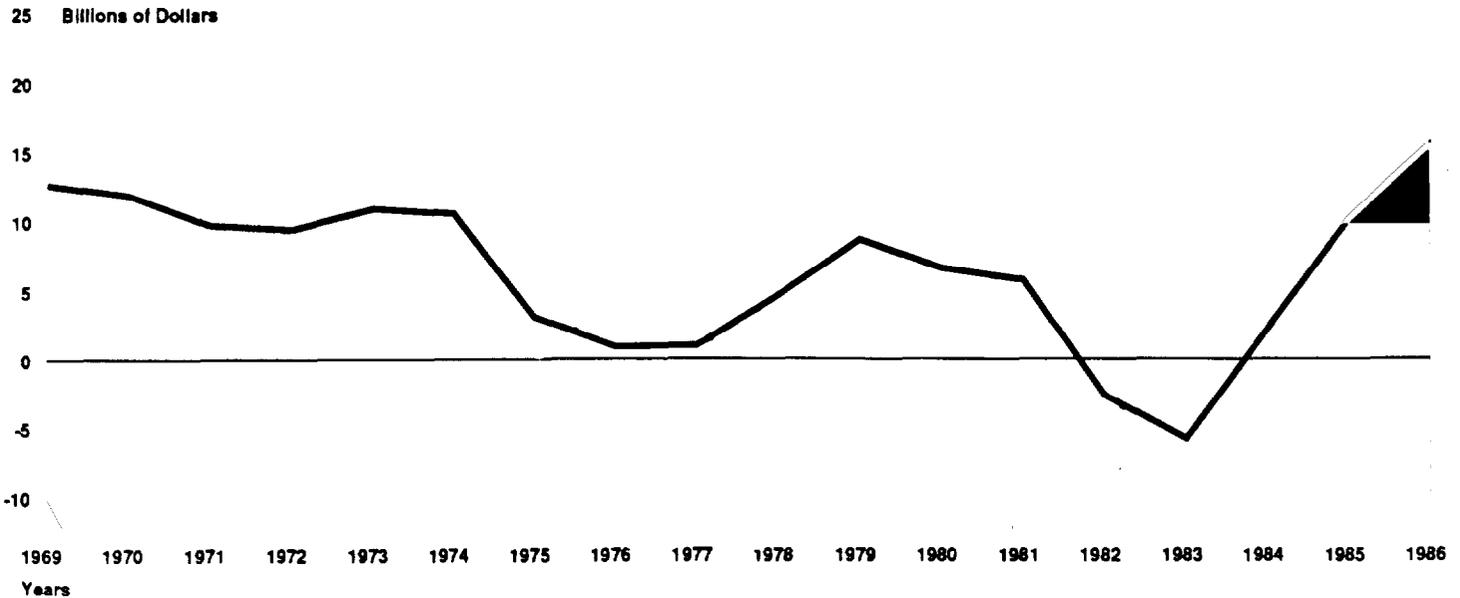
Revenues include all state UI taxes, interest on state trust fund balances and reimbursable benefit payments.

Expenditures include regular state UI benefit payments, the state share of extended benefits and reimbursable benefit payments.

The High Cost Multiple—also known as the Reserve Cost Multiple—is the most widely recognized measure used to assess trust fund reserve adequacy. It is essentially a measure of how long recession-level benefits could be paid from current reserve balances. The High Cost Multiple is calculated by computing the ratio of current net trust fund reserves to current year total wages earned in insured employment. This is divided by the ratio of the largest amount of total state benefit payments experienced previously in any 12 consecutive months to the total wages in insured employment during those 12 months.⁵ One could think of a 1.0

⁵Although research has been conducted to develop alternative reserve adequacy measures, these measures often performed little better than the High Cost Multiple. For a sample summary of selected papers on this topic, see *An Analysis of UI Trust Fund Adequacy*, Report of the Department of Labor under contract no. 99-5-3024-04-090-01 (Dec. 1986), pp. 47-58, and Richard Hobbie and Richard Rimkunas, *Unemployment Insurance in South Carolina: An Analysis of Options to Promote Solvency*, Congressional Research Service, March 16, 1984.

Figure 2.2: Annual Aggregate Net Trust Fund Reserves (1950-86)



High Cost Multiple as indicating that, if aggregate potential benefit payment liabilities rise at the same rate as total wage growth in insured employment, the current balance appears capable of supporting 12 months' worth of benefit payments at the highest rate historically experienced.

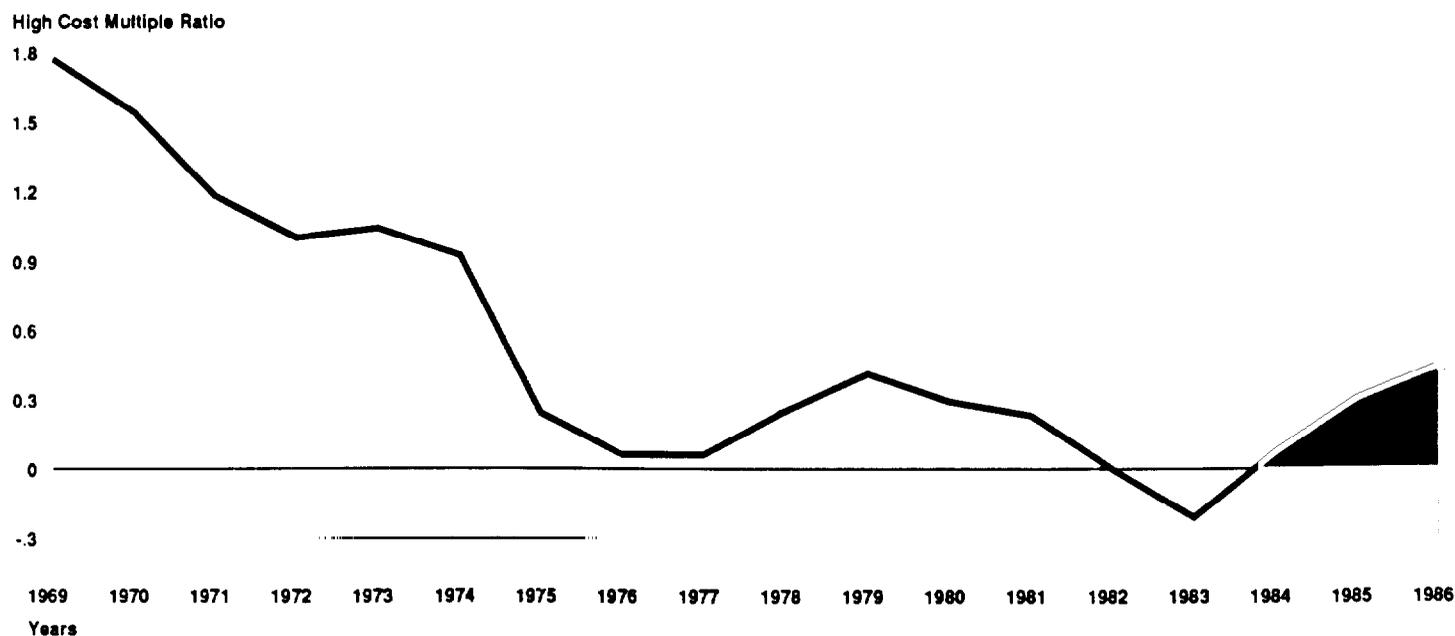
In the past, the Department of Labor recommended that states voluntarily adopt a standard that their trust funds maintain a High Cost Multiple of between 1.5 and 3.0.⁶ State employment security agency administrators have also sanctioned a 1.5 standard as indicative of reserve adequacy. A trust fund meeting the 1.5 standard would have available net reserves 1.5 times greater than the fund's historically worst 12-month experience in benefit payments.

The High Cost Multiple of the aggregate system (the sum of all individual state trust fund net reserves) has declined steadily since the 1950's. Between 1954 and 1969, the aggregate High Cost Multiple registered an annual average of 2.1, indicating a strong financial position. The annual multiple fell fairly steadily during the 1970's and became negative in

⁶Program Letter on Reserve Adequacy. Unemployment Insurance Program Letter No. 44-81. U.S. Department of Labor, Employment and Training Administration, October 13, 1981, p. 3.

1983 before recovering to .07 (see figs. 2.3 and 2.4).⁷ As of the end of 1986, the aggregate system High Cost Multiple for all state funds was 0.44—meaning that reserves on average were sufficient to pay benefits for only about 5 months without additional revenue, much shorter than the average post-World War II recession of 12 months and the 18 months formerly recommended by Labor.

Figure 2.3: Annual Aggregate High Cost Multiples (1969-86)



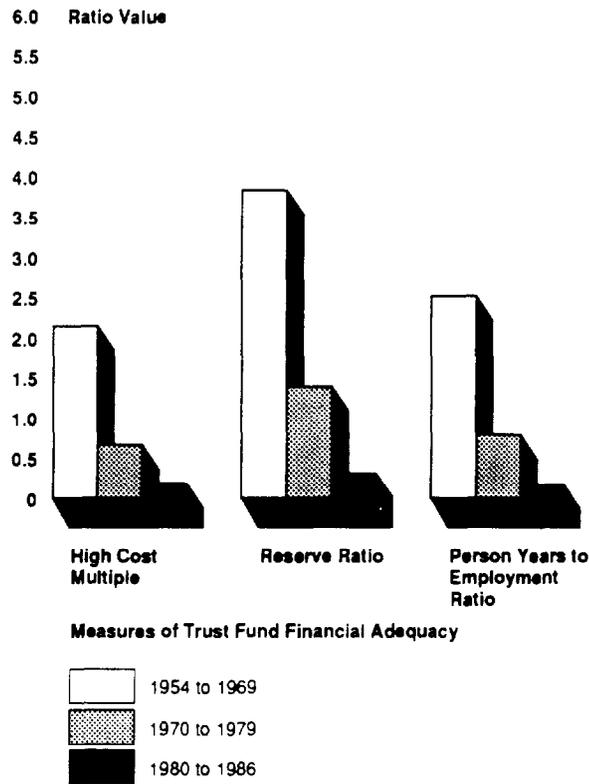
Few State Trust Funds Meet Standards for Financial Adequacy

Assessing the financial adequacy of individual state trust funds leads to a conclusion similar to that reached in the analysis of aggregate reserve levels—few state trust funds are maintaining adequate net reserves. The number of state trust funds with High Cost Multiples above 1.5 has declined over the last 30 years (see fig. 2.5). At the beginning of 1987, only 2 trust funds, Mississippi's and South Dakota's, surpassed the 1.5

⁷Other indicators of trust fund financial adequacy (reserve ratio and person years to employment ratio) suggest similar conclusions (see app. IV).

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Figure 2.4: Period Averages of High Cost
Multiples (1954-86)



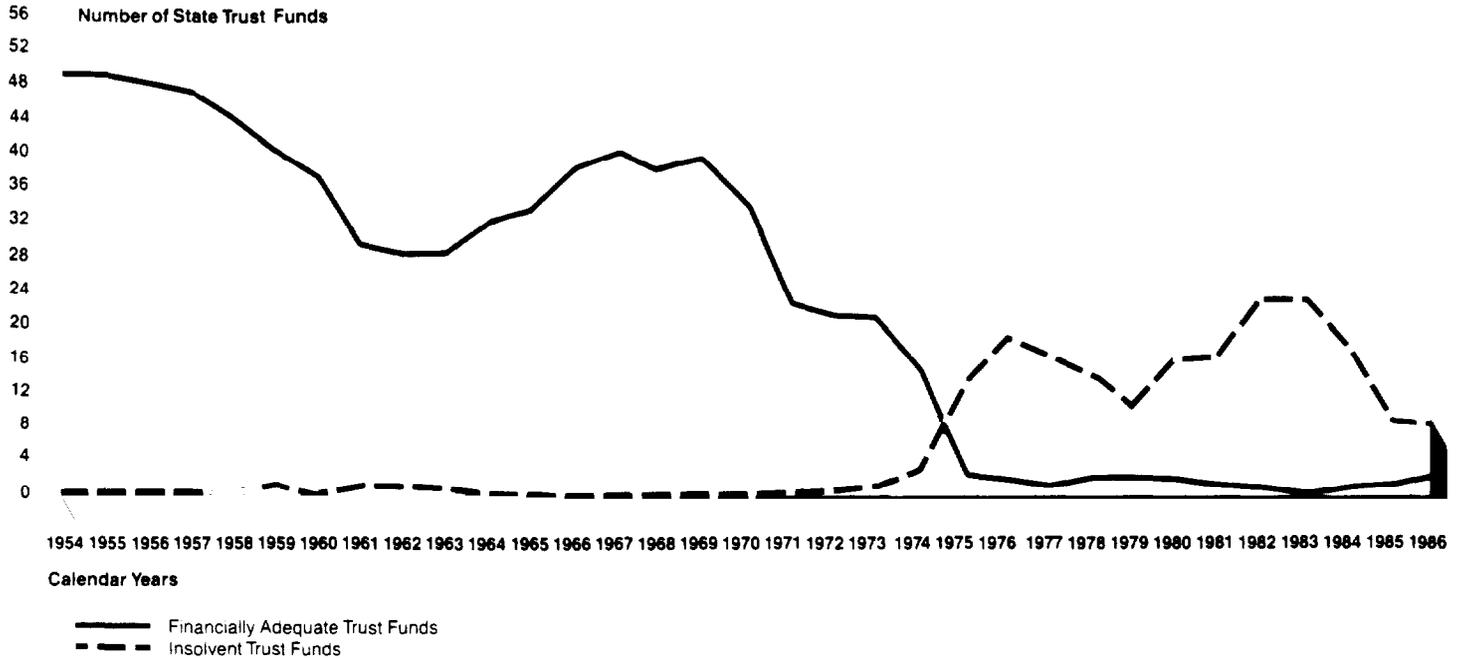
Person years to employment ratio is divided by 10.

standard, compared to 49 funds that exceeded the standard in 1954 and 39 in 1969.

Some analysts consider a 1.5 standard to be too stringent.⁸ However, the use of a less stringent 1.0 standard does not change the qualitative conclusion reached from using the higher standard (see app. IV). As of the end of 1986, 11 state trust funds surpassed the 1.0 standard, as compared with 1969, when 51 out of 53 trust funds did so.

⁸An Analysis of UI Trust Fund Adequacy. Report of the Department of Labor under contract no. 99-5-3024-04-090-01 (Dec. 1986), pp. 47-58.

Figure 2.5: Financial Condition of State UI Trust Funds (1954-86)



Financially adequate funds are all funds with High Cost Multiple ratios of 1.5 and above. Insolvent trust funds have negative net balances at the end of a calendar year.

Number of Insolvent State Trust Funds Has Grown Significantly Since the Early 1970's

The failure to maintain adequate reserves has increased the frequency of state trust funds becoming insolvent during periods of high benefit expenditures. We define trust fund insolvency as the condition when end of the year trust fund balances minus outstanding federal loans are less than 0.⁹ Insolvent state trust funds require federal loans to continue to meet benefit obligations. During fiscal year 1986, state trust funds owed \$4.8 billion in total federal loans, of which \$2.2 billion were new loans.

⁹To borrow any federal funds, state trust funds must forecast to be unable to meet all benefit obligations during at least some 3-month period of the borrowing year. Since 1972, 40 trust funds have borrowed federal funds at least once. However, 9 of these state funds—Florida, Indiana, Nevada, Oregon, South Carolina, Tennessee, Utah, Virginia, and Wyoming—never had end of the year balances minus outstanding loans being less than 0 and thus are not classified in this report as having been insolvent.

Before 1972, only 3 state funds ever received federal loans, and only 1 was ever insolvent at the end of a calendar year.¹⁰ However, the number of insolvent state trust funds increased to 13 in 1975 and to 23 in 1982 and 1983. As of the end of 1986, there were eight insolvent trust funds—those of Illinois, Louisiana, Michigan, North Dakota, Ohio, Pennsylvania, Texas, and West Virginia.

Economic growth, lower unemployment, and a substitution of federal debt with state bond debt has led to a reduction in the number of insolvent state trust funds since the end of 1986. Only the Texas state trust fund remained insolvent at the beginning of 1988. However, most of the newly solvent state trust funds have very low levels of reserves, and none have adequate reserve levels as measured by the High Cost Multiple.

State Trust Fund Insolvency Has Been Chronic

Although some trust fund insolvency has been short term, much has been of long duration—4 or more years (see fig. 2.6). During the 13-year period from 1974 to 1986, 31 state trust funds were insolvent at least once, and 29 were insolvent 2 calendar years or more. Moreover, 23 funds were insolvent for 4 or more years, and 8 funds were insolvent for a decade or more.

Federal policy changes enacted since 1980 increased the costs of insolvency to state funds and encouraged states to repay loans more quickly (see ch. 4). However, some state trust funds still experienced long periods of insolvency during the 1980's. Of the eight states with insolvent trust funds at the end of 1986, five—Michigan, Illinois, Ohio, Pennsylvania, and West Virginia—had been insolvent since at least 1980, and Louisiana had been insolvent continuously since 1982.¹¹ Texas was insolvent between 1982 and 1984, had very small positive net reserves in 1985, and became insolvent again in 1986. North Dakota became insolvent for the first time in 1986.¹²

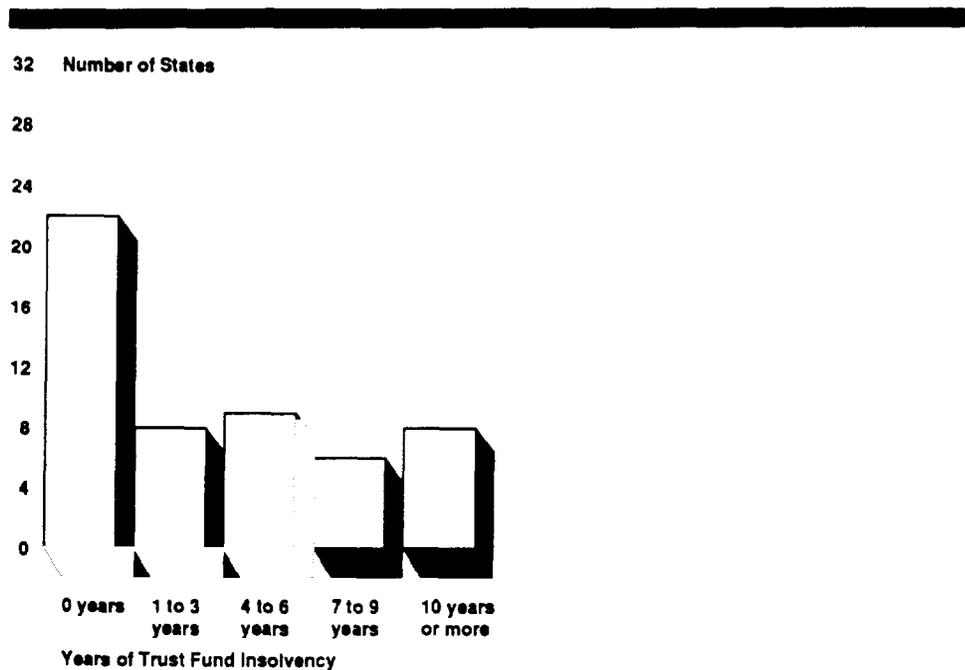
¹⁰Before 1972, only the Alaska, Michigan, and Pennsylvania trust funds had ever received federal loans, and only one UI fund, Alaska's in 1957, was insolvent.

¹¹The Illinois and Pennsylvania trust funds had been insolvent between 1975 and 1986. Michigan had been insolvent every year during that period except 1979. The West Virginia and Ohio trust funds first became insolvent in 1980.

¹²North Dakota had borrowed federal funds before 1986, but had repaid the loans within the same calendar year. Ohio first borrowed in 1977 but repaid the loan during the same year.

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Figure 2.6: Number of Insolvent State Trust Funds by Duration of Insolvency (1974-86)



Lower unemployment has helped five insolvent trust funds—Illinois, Louisiana, North Dakota, Ohio, and West Virginia—to repay their federal loans during 1987, mostly during the last 4 months of the year. Two other states—Pennsylvania and Michigan—still had large outstanding federal loans at the beginning of 1988 but had accumulated sufficient funds to register positive net reserves, leaving Texas with the only remaining insolvent trust fund as of January 1988.

Despite this improvement, none of these newly solvent states have anywhere near adequate reserve levels as measured by the High Cost Multiple.¹³ Preliminary Labor estimates of early 1988 net reserves for the eight trust funds insolvent at the beginning of 1987 show that four states had net reserves of \$65.3 million or less.¹⁴

¹³As of the end of 1987, Illinois had a High Cost Multiple of .14; Ohio, .10; West Virginia, .20; North Dakota, .26; Michigan, .01; Pennsylvania, .05; and Louisiana, only slightly above 0.

¹⁴Preliminary Labor estimates of early 1988 net reserves for the eight states with insolvent trust funds at the beginning of 1987 are as follows: Texas, -\$510 million; Michigan, \$25 million; Pennsylvania, \$117 million; North Dakota, \$15 million; Illinois, \$313.6 million; Louisiana, \$0.7 million; Ohio, \$213.6 million; and West Virginia, \$65.3 million.

Several of these states substituted state bond indebtedness for their federal debt. Two states—Louisiana and West Virginia—repaid their federal loans by issuing state bonds. In September 1987 the West Virginia legislature authorized the state to repay \$258 million in federal loans by issuing state bonds. The bonds were financed by a supplemental tax on UI covered wages shared equally by both employers and workers; the tax expires when repayment is completed. Louisiana approved legislation calling for a \$1.2 billion bond issue to pay off its federal loans and to create a reserve in the state UI trust fund. This bond issue is financed by a separate employer tax. The legislation also includes an increase in the state taxable wage base, and a 7-percent reduction in UI benefits, which does not finance the bonds.

Severity of Insolvency Problems Varies by Region

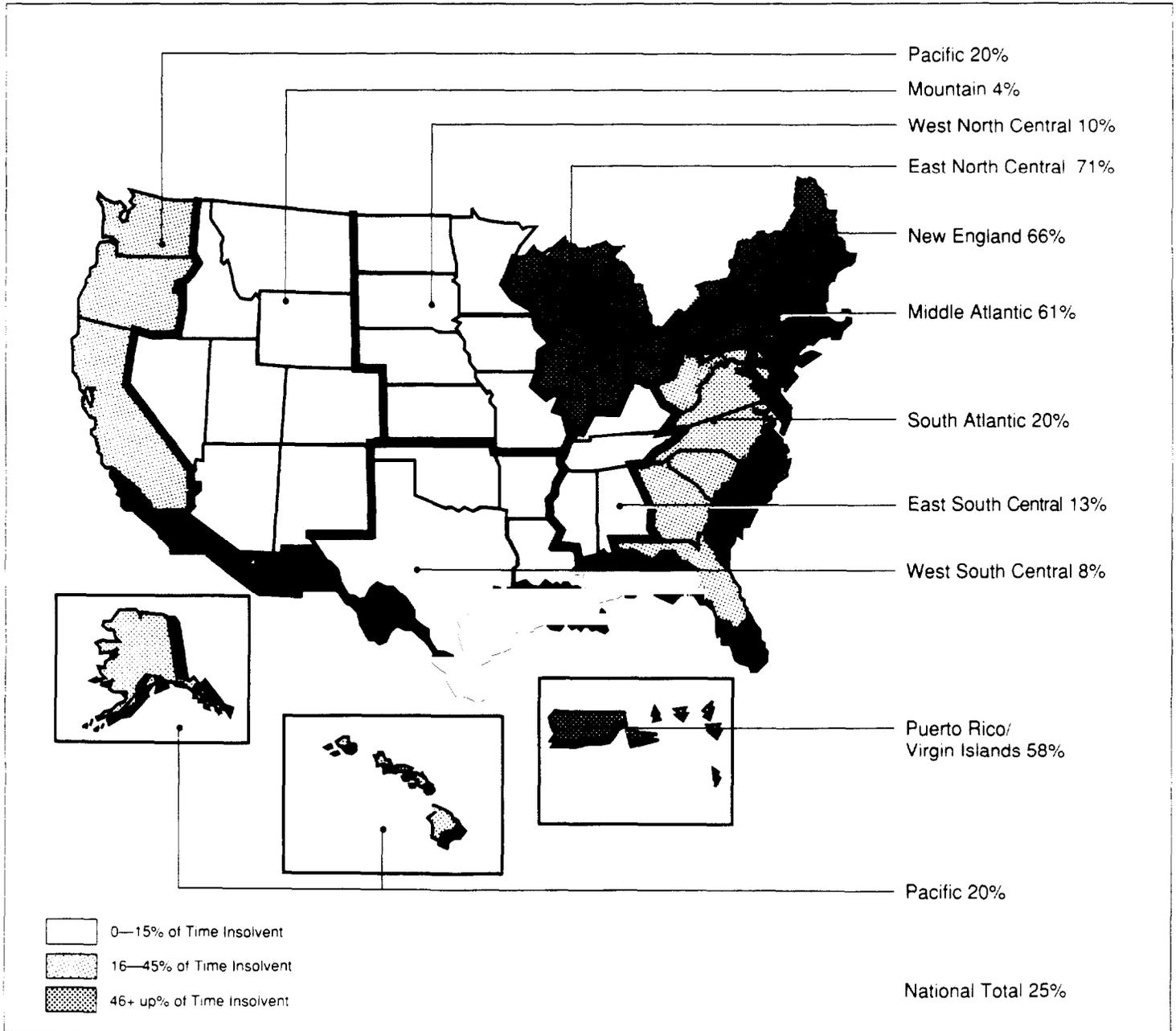
The states that have experienced the greatest difficulty in maintaining solvent trust funds tend to be in regions where economic activity has been more depressed than in the nation in general. Reflecting their relatively higher unemployment rates between 1974 and 1986, states in the East and the North experienced more severe trust fund insolvency problems. Between 1972 and 1986, 6 of the 10 largest state trust fund borrowers were located in the East North Central or Middle Atlantic census divisions. In addition, the proportion of federal loans received by Eastern and Northern trust funds was much larger than those received by Southern and Western trust funds, both in absolute terms and as compared to each region's percentage of national system-insured wages (see app. IV).

To measure the amount of cumulative trust fund insolvency on a regional basis, we computed an "insolvency" index measuring the proportion of time all the trust funds in each census division were insolvent over the period 1974-76.¹⁵ During that period, trust funds in the East North Central region were insolvent, on average, about half of the time, and those in the Middle Atlantic region almost 60 percent of the time (see app. IV). Meanwhile, trust funds in the Western and Southern states, especially the East South Central, Pacific, and Mountain regions, experienced the least insolvency—between about 10 and 20 percent of the time—since 1974.

¹⁵The "insolvency" index is the number of total insolvent program years for each census division divided by each division's total number of program years during the time period. An insolvent program year is a calendar year in which an individual trust fund has been designated insolvent as we previously defined.

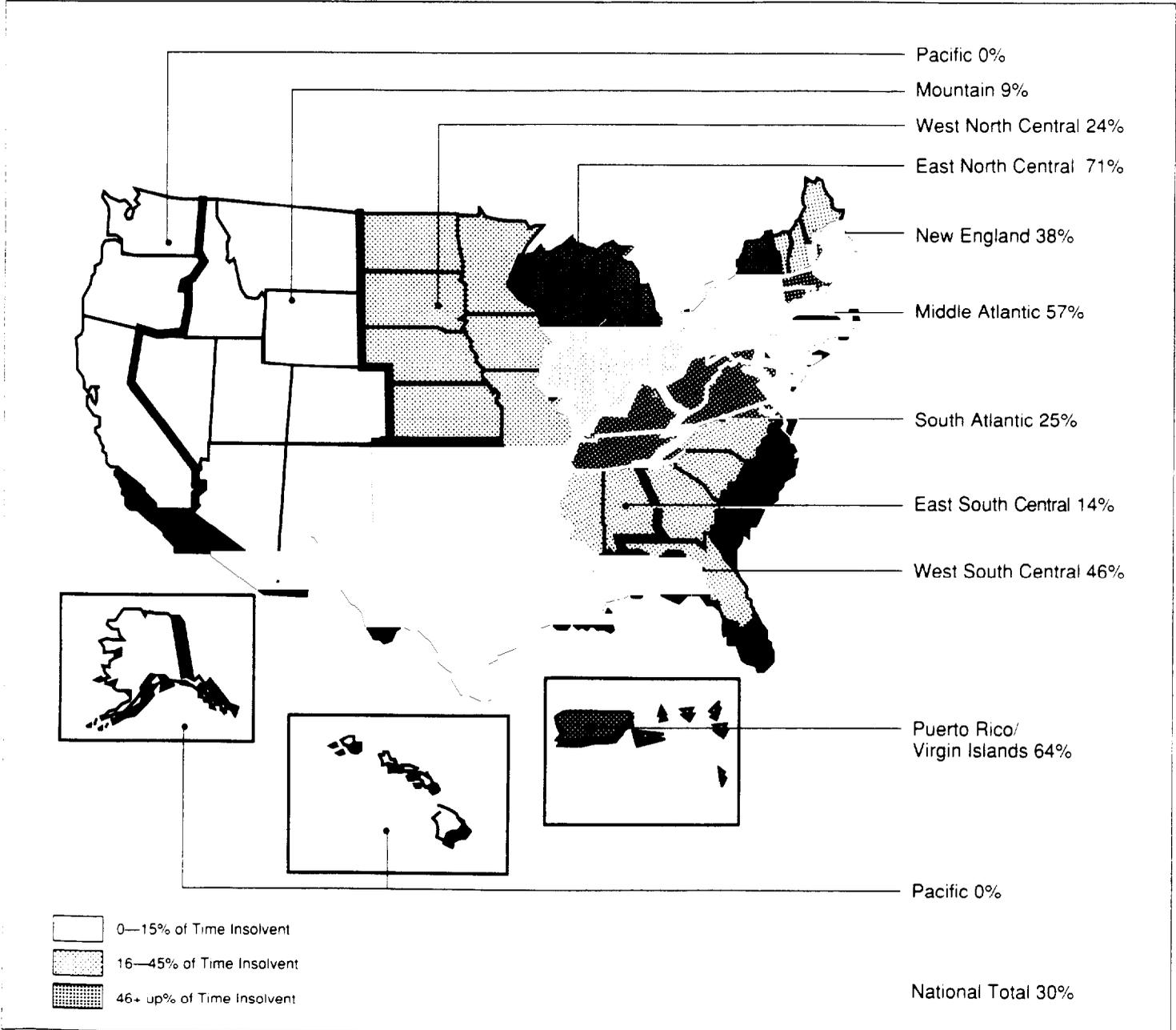
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Figure 2.7: Map of Insolvent Trust Fund Program Years, by Census Designation (1974-79)



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Figure 2.8: Map of Insolvent Trust Fund Program Years, by Census Designation (1980-86)



This concentration of trust fund borrowing in the East and the North is related to those regions' economic performance below the national average in terms of unemployment and job growth since 1970. Meanwhile, Southern and Western state trust funds were aided by more buoyant economic conditions during the 1970's. The average annual employment growth rate for the Northeast and Midwest/North Central census regions during the 1970's was well below the national average of 2.5 percent, and only about half the corresponding rate in the South and West, even though unemployment was relatively high in the South and the West (see app. IV).¹⁶ Faster employment growth and reduced joblessness builds trust fund reserves and cuts benefit outlays. Slower growth, which tends to increase unemployment, reduces UI revenue and increases benefit outlays.

During the 1980's, Northeastern trust funds have improved financially, while the West South Central area has experienced a decline in trust fund solvency. New England trust fund insolvency decreased from 66 percent of the time during the 1970's to only 38 percent between 1980 and 1986, while the West South Central division trust fund insolvency increased from 8 to 46 percent (see figs. 2.7 and 2.8). Again this development is related to changes in regional economic conditions. The average annual employment growth rate differential between the North and the East compared to the South and the West has narrowed during the 1980's (see app. IV). Further, unemployment rose sharply in the West South Central states between 1980 and 1986, while it declined significantly among the New England states.¹⁷

Forecasts Predict Continued Trust Fund Weakness

Our analysis of Labor Department trust fund projections, a National Governors' Association report, and four alternative scenarios constructed from a model of the Massachusetts trust fund all suggest that trust fund reserves will not reach the 1.5 High Cost Multiple standard even under conditions of relatively strong economic growth.¹⁸ All three

¹⁶The average annual employment growth rate for the Northeast and Midwest/North Central census regions during the 1970's was 0.9 and 1.9 percent, respectively, while the Southern and Western census regions averaged 3.7 and 4 percent, respectively.

¹⁷The New England unemployment rate fell from an annual average of 6.9 percent during the 1970's to 5.7 percent between 1980 and 1986. Meanwhile, average annual unemployment increased sharply to 7.5 percent in the West South Central census division between 1980 to 1986, compared to 5.2 percent during the 1970's.

¹⁸Relatively strong economic growth is defined as average increases of 3.5 percent annually in the Gross National Product adjusted for inflation.

simulations predict that future economic growth for the forecasted periods will continue to increase net trust fund reserves, although at a rate below that necessary to achieve or maintain financial adequacy using the High Cost Multiple. The simulations also show that a moderate to severe recession will significantly reduce the recent accumulation of trust fund net reserves, increase the number of insolvent trust funds, and possibly damage the reserve adequacy of even financially healthy trust funds.

Labor Department Projections

The January 1987 Department of Labor trust fund projections for fiscal years 1987-92 predicted an increase in aggregate net reserves through fiscal year 1990 (see app. I). Building on the recent reserve growth, Labor forecasted that aggregate net reserves (total trust fund reserves minus federal loans) will grow 62 percent between fiscal year 1986 and fiscal year 1990 (see fig. 2.9). Yet, despite the predicted reserve growth, aggregate trust fund financial adequacy, measured by the High Cost Multiple, will improve only marginally to an annual period average of 0.45, remaining well below the 1.5 and 1.0 standards.

A projected recession in fiscal year 1988 illustrates the system's lack of adequate financial reserves. At our request, the Labor Department projected the impact on state trust fund reserves of a recession in fiscal year 1988. Labor found that aggregate net reserves would decrease significantly from fiscal year 1987 and the number of insolvent trust fund would increase from 7 at the end of fiscal year 1987 to 17 (see table 2.1). Even though the economy is assumed to recover in fiscal year 1989, the projected number of insolvent trust fund states would remain at 17 before declining in later years.¹⁹

¹⁹Because of lower than anticipated unemployment during 1987, later projections performed by Labor in August 1987 show a greater increase in net reserves, peaking at \$31.3 billion in fiscal year 1992. Under these conditions, a projected recession in fiscal year 1988 may not have as severe an impact. However, the qualitative effect would be the same—reserves would decline and trust fund insolvency would increase significantly.

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Figure 2.9: Labor Department Projected Net Reserves and High Cost Multiples—Administration Economic Assumptions of January 1987 (Fiscal Years 1984-92)

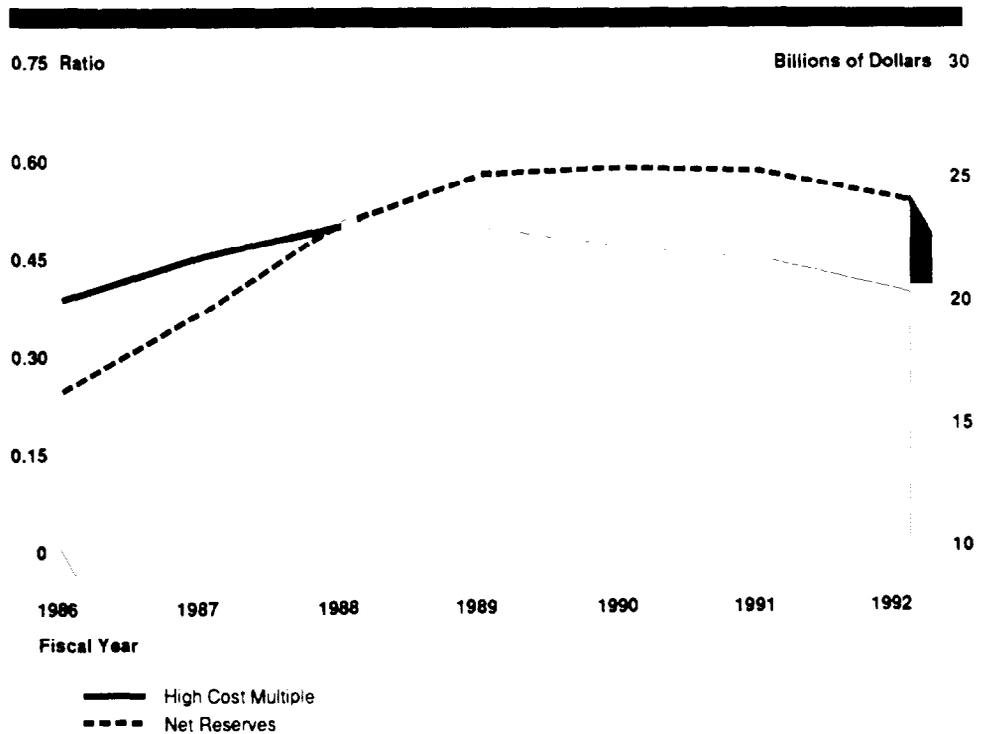


Table 2.1: Impact on Aggregate UI Trust Fund Reserves and State Trust Fund Solvency of Recession in Fiscal Year 1988, Labor Trust Fund Model Projections of January 1987

	January 1987 Labor projections ^a		
	End of FY 1987	End of FY 1988	End of FY 1989
Aggregate net trust fund reserves	\$19.6	\$5.9	\$8.3
Number of insolvent trust funds	7	17	17

^aAt the end of fiscal year 1987 under the administration's assumptions, trust funds were projected to be insolvent in seven states.

National Governors' Association Report

NGA's 5-year (1985-89) projection of five state trust funds with serious solvency difficulties in 1984 suggests that although net reserves are likely to increase, a recession will quickly return these funds to insolvency.²⁰ NGA requested five states with large trust fund debts—Illinois, Michigan, Ohio, Pennsylvania, and Wisconsin—to provide individual projections of total and insured unemployment, annual UI taxes, benefit

²⁰Wayne Vroman, *Unemployment Insurance Financing: Problems and Prospects*, Center for Policy Research, National Governors' Association, February 1985.

outlays, net reserves, and loans.²¹ The author used these forecasts to assemble aggregate projections of trust fund reserves, outstanding loans, and loan repayments for calendar years 1985-89. Together, the projections forecasted annual UI revenues of about \$6 billion, with total annual benefit outlays remaining under \$5 billion. As a result, combined net trust fund reserves were projected to grow by nearly \$12 billion, from -\$7.2 billion in 1984 to +\$4.5 billion in 1989, with total outstanding loans decreasing from \$7.3 billion to \$1.4 billion.

However, despite 5 years of continuous projected net reserve growth, the state trust funds will remain vulnerable to recession. Projected 1989 total UI benefit payments for the five states equal \$4.9 billion, equivalent to about 1.4 percent of the states' combined insured payroll. If a recession occurred in 1989, generating benefit outlay levels roughly equal to the five states' benefit payout experience in 1982, it would eliminate the projected \$4.5 billion of aggregate net reserves accumulated by the states through the end of 1989, returning the five trust funds to aggregate insolvency.²²

GAO Analysis of Individual State Trust Fund Model

To determine how severe a recession would be necessary to push even a healthy state trust fund into financial difficulty, we used a simulation model of a state's UI trust fund.²³ Of the trust funds considered for modeling,²⁴ we eventually chose Massachusetts because of its currently strong fund balance after experiencing insolvency during the early 1970's; its high maximum weekly benefit amount and duration; its tax structure, which is responsive to changes in trust fund balances; and its

²¹The five states represented 77 percent of aggregate UI program debt to the federal government in 1984. Although each state's individual forecast assumptions were unavailable, the five states projected an aggregate decline in total unemployment from 9.2 percent in 1985 to 8.1 percent in 1989 and a decline in insured unemployment from 3.9 to 3.6 percent.

²²See Vroman, p. 45. Although unemployment during the 1982 recession was extremely severe, the system's aggregate ratio of UI benefits paid to total program insured wages was not atypical for the postwar recessions. The 1982 ratio of 1.72 percent was below that reached in 1949 (1.85 percent), 1958 (2.05 percent), and 1975 (2.03 percent) and the same as 1961 (1.72 percent).

²³Dr. Wayne Vroman developed a simulation model of the Massachusetts trust fund for us. See appendix II for a description of the model.

²⁴We also considered the Alabama, California, Delaware, Florida, Maryland, New Jersey, North Carolina, and Virginia trust funds as candidates for modeling.

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reputation for implementing innovative labor market programs, some of which interact directly or indirectly with UI.²⁵

The Massachusetts trust fund is financially stronger than the average trust fund. As of the end of 1986, it had \$990 million in net reserves (surpassed only by New Jersey, North Carolina, Florida, New York, and California), and its High Cost Multiple was 0.61, also larger than many state trust funds.

We examined the performance of the Massachusetts trust fund under four alternative scenarios, ranging from strong, stable economic growth to major recession, over the period 1987-96 (see table 2.2). In each of the projected situations, trust fund reserve adequacy, as measured by the High Cost Multiple, deteriorates—even under conditions of strong stable economic growth (see fig. 2.10). High wage inflation significantly reduces net reserves, although the fund remains solvent. A moderate recession—equivalent to 85 percent of the national average in unemployment between 1980 through 1986 and declining thereafter—nearly eliminates trust fund reserves, while a major recession—equivalent to actual Massachusetts experience during the 1970's—pushes the fund into insolvency, requiring federal loans to pay benefits (see fig. 2.11).

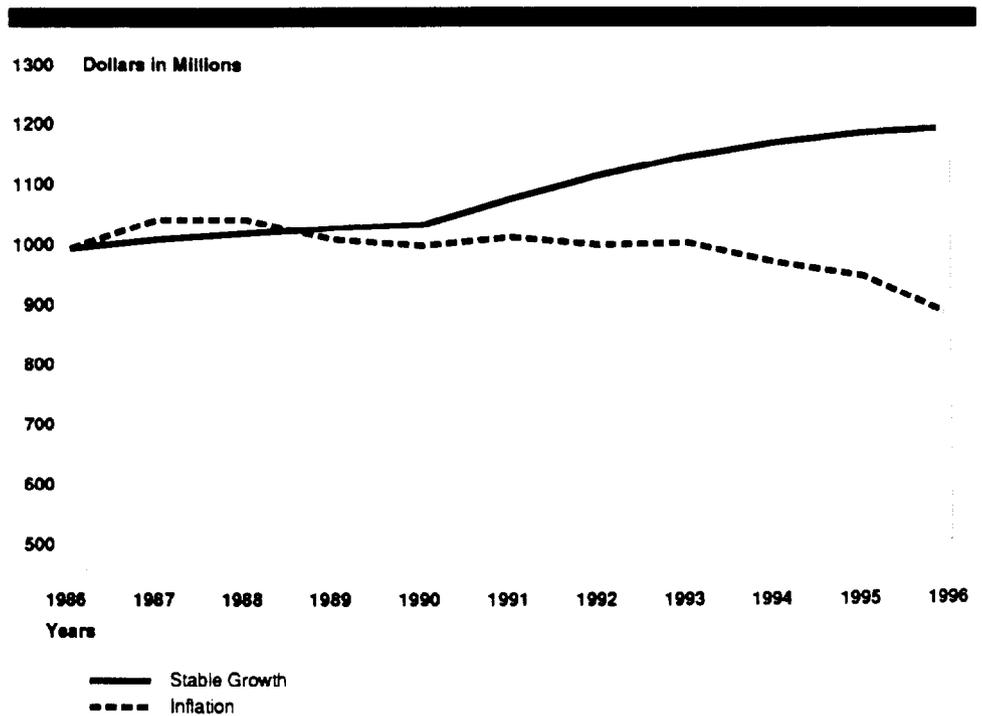
Table 2.2: Outcomes and Economic Assumptions of the Massachusetts Trust Fund Model Scenarios (1987-96)

Scenario	Unemployment rate	Wage inflation rate	Outcome
Stable growth	3.8 ^a	3.0 ^a	20 percent reserve growth but no improvement in reserve adequacy (High Cost Multiple)
Inflation	4.0 ^a	8.0 ^a	Steady decline in reserve adequacy (High Cost Multiple)
Moderate recession	85 percent of the actual annual national unemployment rate for 1980-86	4.0 ^a	Significant decline in reserve adequacy (High Cost Multiple)
Severe recession	Massachusetts' actual annual unemployment rate for 1970-79	Massachusetts' actual annual wage inflation rate for 1970-79	Elimination of trust fund reserves; insolvency

^aAll years.

²⁵Massachusetts pays additional weeks of UI benefits to all claimants enrolled in approved training programs. In cases of total or partial plant closures, the state has established a Reemployment Assistance Program, which provides counseling and various reemployment services. Participants are eligible to receive up to 13 weeks of general revenue financed reemployment assistance benefits in addition to their regular UI benefits.

Figure 2.10: Massachusetts High Cost
Multiples for Stable Growth and Inflation
Scenarios (1986-96)



Origins of UI Trust Fund Insolvency

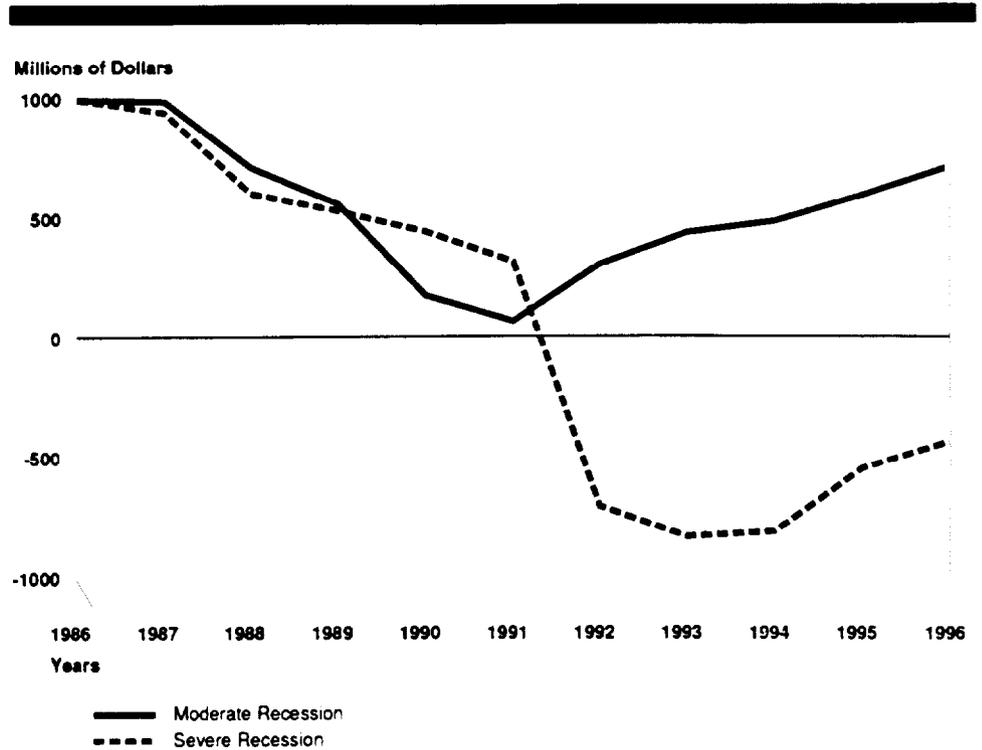
The decline in reserve adequacy and the growth in trust fund insolvency has been caused by several factors, including the high unemployment generated by three major recessions during the last 15 years, increases in benefit expenditures resulting from the creation of the extended benefits program that were not funded by additional state revenues, and the imbalance in some states between increasing inflation-indexed benefit payments and nonindexed taxes.²⁶

Declining Economic Growth and Rising Unemployment Led to Increased UI Expenditures

One cause of the UI program's financial difficulties has been the American economy's weaker performance since 1970 compared with the previous two decades. Three major recessions have lowered post-1970 real economic growth below the average 4.6-percent annual rate common during the 1960's (see fig. 2.12). Recession has led to higher total and adult male unemployment during the 1980's through 1986. Long-term unemployment has also increased significantly during this latter period, remaining high even as the economy has recovered.

²⁶See Vroman, *The Funding Crisis in State Unemployment Insurance*, Upjohn, 1986, pp. 21, 31 and 34.

Figure 2.11: Massachusetts Net Trust Fund Reserves for Moderate and Severe Recession Scenarios (1986-96)

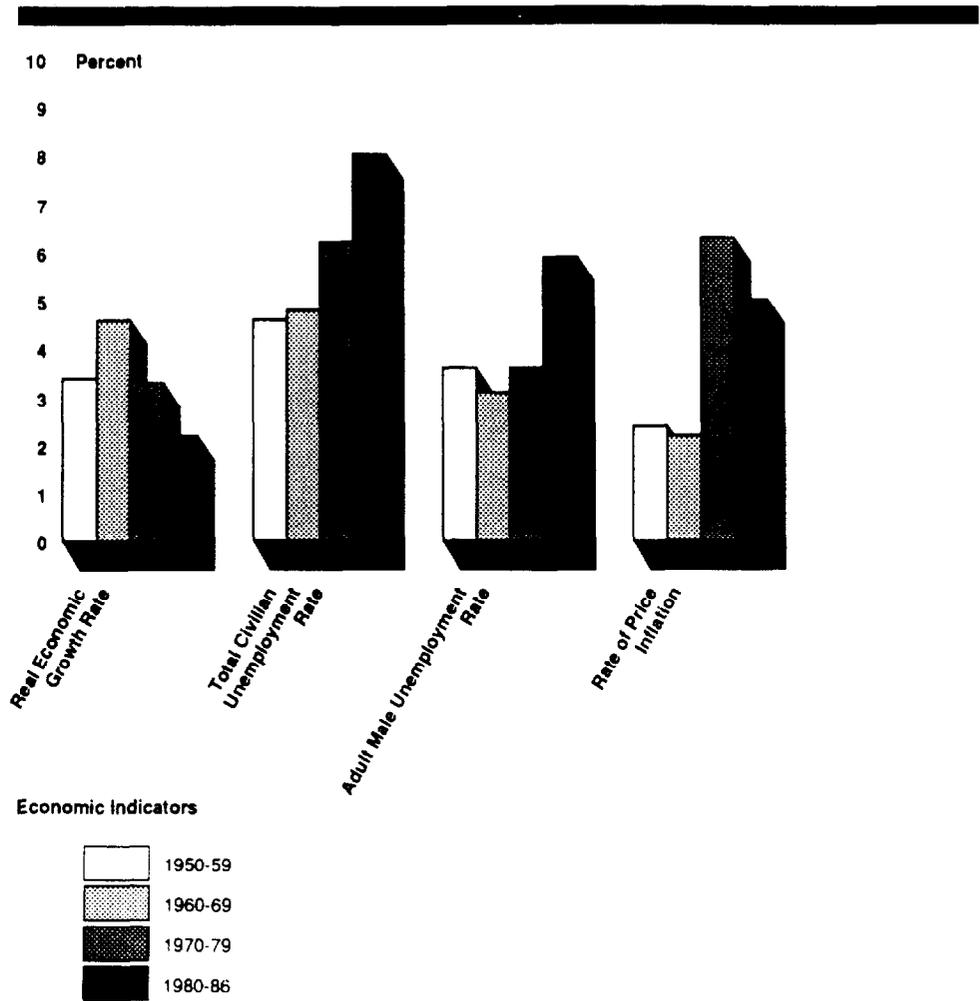


Higher unemployment rates increase total UI benefit expenditures by increasing the number of claims, and hence total benefit payments collected by claimants. Higher unemployment levels are often associated with more high-wage workers being laid off, which tends to increase average weekly benefits. Higher rates of joblessness also lengthen the average benefit duration, again raising benefit outlays. Increases in prime age, adult unemployment also raise claims and benefit payments because adult workers are more likely to be eligible for benefits than younger workers.

State Share of Extended Benefits Has Contributed to State Fund Solvency Difficulties

The federal extended benefits program, established by the Federal-State Extended Unemployment Compensation Act of 1970, has contributed to trust fund financial difficulties because many states did not initially increase revenues to finance the increase in mandated benefit outlays. Under this program, extended benefit costs are shared equally by the federal and state governments. The state trust fund share of extended benefits has been large, totaling over \$8.5 billion between 1971 and 1986. Because raising UI taxes is often controversial, in the past most

Figure 2.12: Average Annual U.S. Aggregate Economic Performance (1949-86)



The real economic growth rate is the annual growth rate in real Gross National Product. The adult male unemployment rate is for all males age 25 and over. The rate of price inflation is measured by the average changes in the Consumer Price Index for all Urban Consumers (1967 = 100).

states did not sufficiently finance their share of extended benefits.²⁷ The result was the erosion of trust fund reserves, trust fund insolvency, or both.

Because extended benefits are triggered by high or rising insured unemployment rates, they will tend to have a larger impact on states already

²⁷Vroman, p. 35.

experiencing large benefit payouts and solvency difficulties.²⁸ To the extent that states did not raise compensating revenue, the extended benefits program eroded trust fund reserves more quickly or pushed the fund deeper into insolvency.

However, under similar circumstances in the future, the federal extended benefits program will be a less important cause of trust fund financial difficulty. Most states now charge employers for extended benefits, and in addition, federal program modifications enacted during the 1980s have made it more difficult for states to trigger the extended benefits program into operation.²⁹

Benefit Indexing Raised Expenditures Above Revenue Increases

Since 1960, many state trust funds have indexed maximum benefit levels but have not comparably indexed or otherwise increased their state UI taxes. Indexation has helped to maintain benefit levels commensurate with overall wage growth. However, during inflationary periods like the 1970's, indexation increased benefit expenditures in many states even as the UI tax base declined in real terms and as a proportion of total system insured wages. With no other changes, this tended to lower the tax rate on total wages. Coupled with the rising unemployment of the last two decades, the imbalance between benefits and revenues siphoned off trust fund reserves, eroding trust fund solvency.

Benefit indexation has become increasingly common among state UI programs. During the 1960's and 1970's many state UI programs indexed maximum weekly benefits, generally to the state's average weekly wage in manufacturing or total insured employment. In 1971, 25 states had benefit indexation provisions in their UI laws. This number grew to 37 by 1987, including many large state programs.³⁰ In addition, some states have enriched their index provisions, permitting the maximum weekly benefit amount to equal a larger fraction of the state's average weekly wage. In 1971, the maximum weekly benefit amount equaled or

²⁸For example, between 1971 and 1983, the cumulative state share of extended benefits for four insolvent trust funds—Illinois, Michigan, Ohio, and Pennsylvania—represented from 22 to 41 percent of their total federal trust fund debts as of the end of 1983.

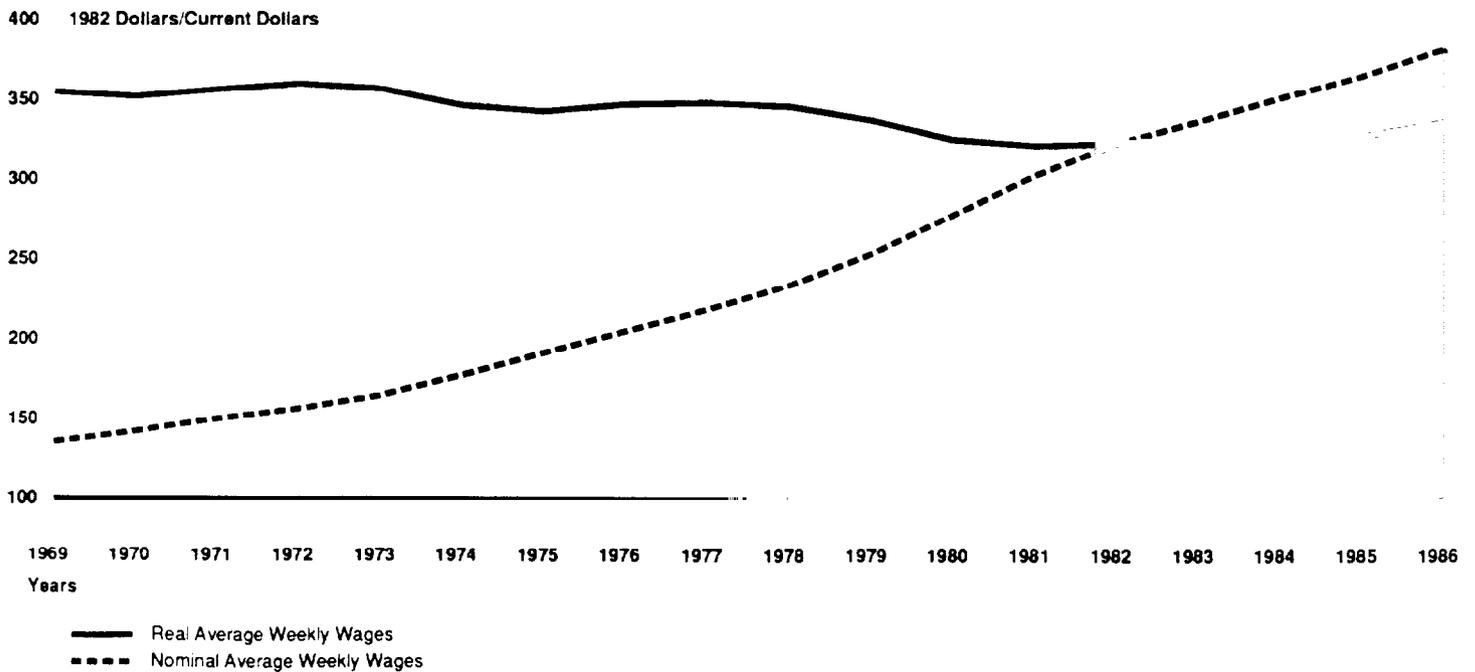
²⁹By 1988, only 15 states still exclude extended benefits from state UI taxes.

³⁰Since the 1982 recession, some states have temporarily frozen their benefit indexation provisions.

exceeded 60 percent of a state's average weekly wage in only 8 states. By 1983, 22 states equaled or exceeded this 60-percent level.³¹

Indexation has helped to maintain benefit growth fairly equivalent with overall wage growth. Average weekly UI benefits have steadily followed the growth in total system insured wages since 1969 (See figs. 2.13 and 2.14). The gross replacement rate—the proportion of the state average weekly wage replaced by the average weekly benefit—has remained roughly constant at 35 percent.

Figure 2.13: Nominal and Real Weekly Wages in System Insured Employment (1969-86)

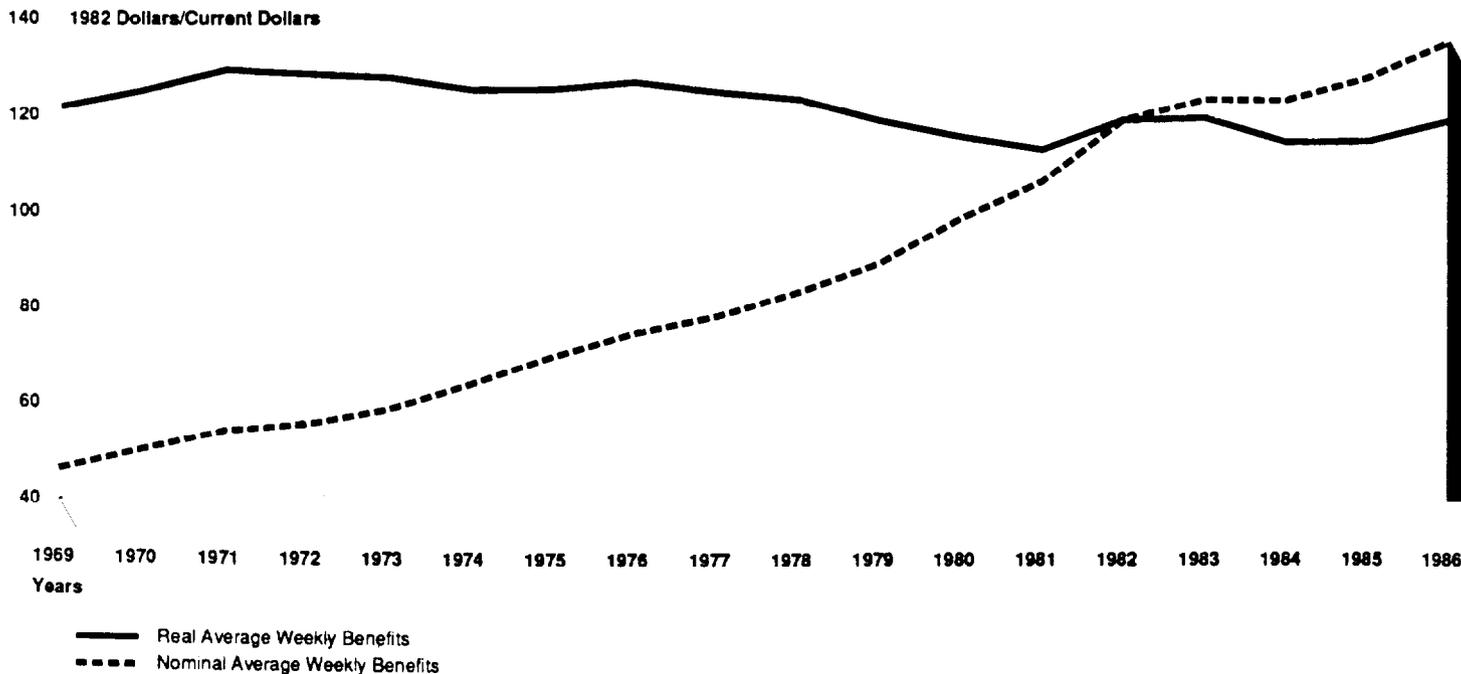


Real average weekly wages in 1982 dollars are adjusted for inflation using the Consumer Price Index for Urban Consumers with 1982 as base year.

In response to benefit indexation, states could have correspondingly indexed or otherwise increased the wage base on which state UI taxes

³¹Increasing the maximum weekly benefit does not necessarily mean that the average weekly benefit rises as well. The average weekly benefit amount would depend on the distribution of eligible UI claimants' pre-unemployment earnings.

Figure 2.14: Nominal and Real Weekly UI Benefits (1969-86)



Real average weekly benefit amounts in 1982 dollars are adjusted for inflation using the Consumer Price Index for Urban Consumers, with 1982 as the base year.

were paid. However, many chose not to do so, raising their wage bases only slightly above the mandated federal level. Driven by inflation, this asymmetry between the indexed benefits and nonindexed revenues has contributed to solvency difficulties experienced by many of these states.³² By 1987, only 18 states had indexed their state UI tax bases, while 20 states had indexed maximum weekly benefits without indexing their taxable wage base (see app. III).

Many states have increased UI tax rates on taxable wages over the last 20 years. However, because most states and the federal government have not significantly increased their taxable wage bases, the proportion of total wages that are taxable has declined. Consequently, the average UI tax rate on total wages, essentially an average "effective tax

³²Of the 20 trust funds that have indexed weekly benefit amounts but have nonindexed tax bases, 18 either currently experience or have experienced solvency problems over the last 15 years: Arkansas, Colorado, Connecticut, Delaware, Illinois, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Ohio, Pennsylvania, Puerto Rico, South Carolina, Texas, Vermont, Wisconsin, and West Virginia.

rate," has increased only slightly since the 1960's, despite the growth of benefit indexation and other changes.

States are required by federal law to maintain their state UI taxable wage bases at least at the level of the taxable wage base for the federal UI tax—currently \$7,000 per worker per year. However, despite some recently legislated increases, the federal base has fallen in real terms by almost one-third since 1965 (see fig. 2.15). The federal tax base now accounts for only about 40 percent of all system insured wages, whereas in 1950 it accounted for close to 80 percent (see fig. 2.16). Even though many state trust funds have boosted their state UI wage bases above the federal tax base floor, most have stayed close to it. In 1987, although 35 states had taxable wage bases above the \$7,000 federal level, only 17 were above \$10,000.³³

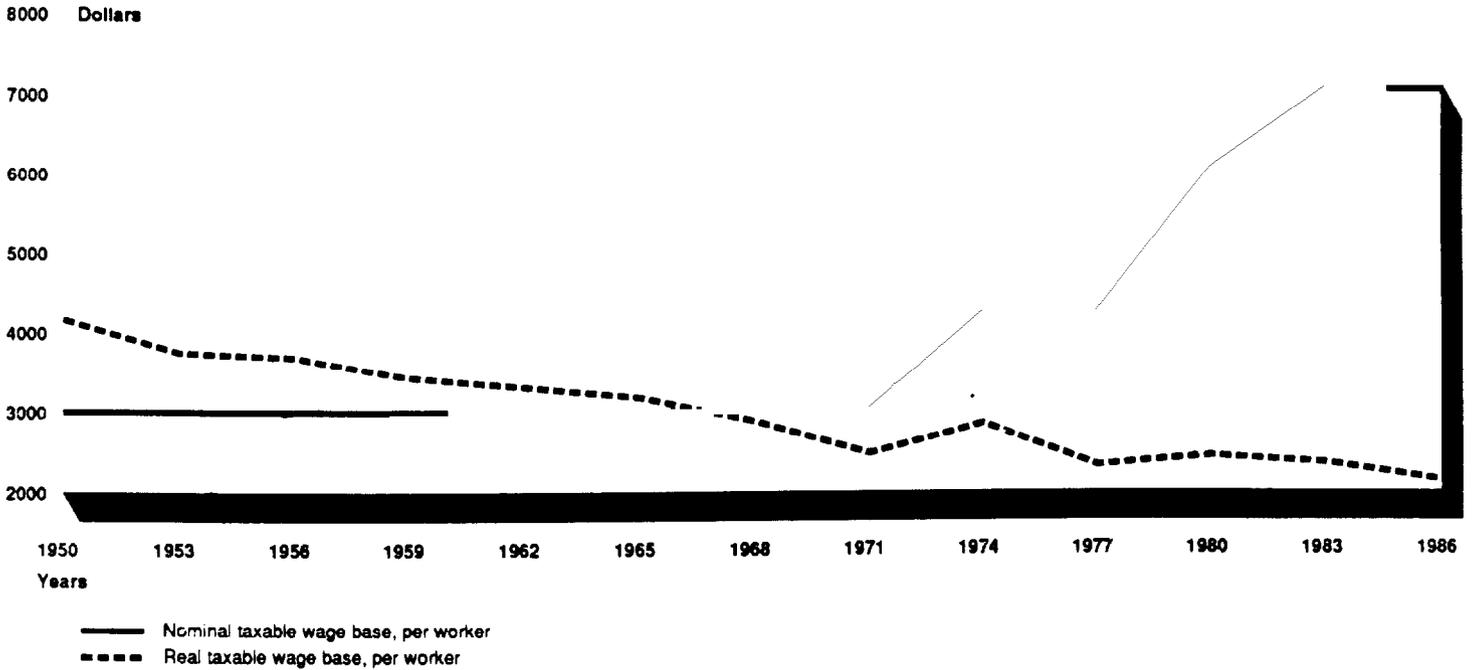
Many states have increased UI tax rates on taxable wages, with some states implementing a series of tax rates that are responsive to changes in the state's reserve balance as a percentage of state payrolls or other measures.³⁴ Average UI tax rates on taxable wages have risen significantly over the last 20 years. The average tax rate on UI taxable wages during the 1980's is double the average 1950's rate and 50 percent higher than the average annual 1960's rate (see table 2.3). However, because of the declining fraction of taxable wages to total system insured wages, tax rates on total system insured wages, which could be considered "effective" employer tax rates, are roughly equal to 1960's levels. This suggests that aggregate state UI taxation has not increased with the growth of indexation and other benefit expenditures changes.

³³To the extent that UI taxable wages continue to decline as a proportion of total system insured wages, UI taxes in many states will increasingly resemble a "head" tax based on the number of employees rather than a tax based on wages. This development has implications for national policy beyond the scope of this report.

³⁴For example, in 1987 Illinois amended its state UI law to implement a number of tax rate increases and benefit reductions that are triggered by the level of state UI trust fund reserves. Such modifications would appear to erode further the UI program's antirecessionary stimulus, continuing the decline already identified. Gary Burtless, The Adequacy and Countercyclical Effectiveness of the Unemployment Insurance System. Testimony before the Committee on Ways and Means, U.S. House of Representatives, December 15, 1987.

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Figure 2.15: Federal UI Taxable Wage Base in Real and Nominal Terms (1950-86)



The real taxable wage base in 1967 dollars is adjusted for inflation using the Consumer Price Index for urban wage earners (1967 = 100).

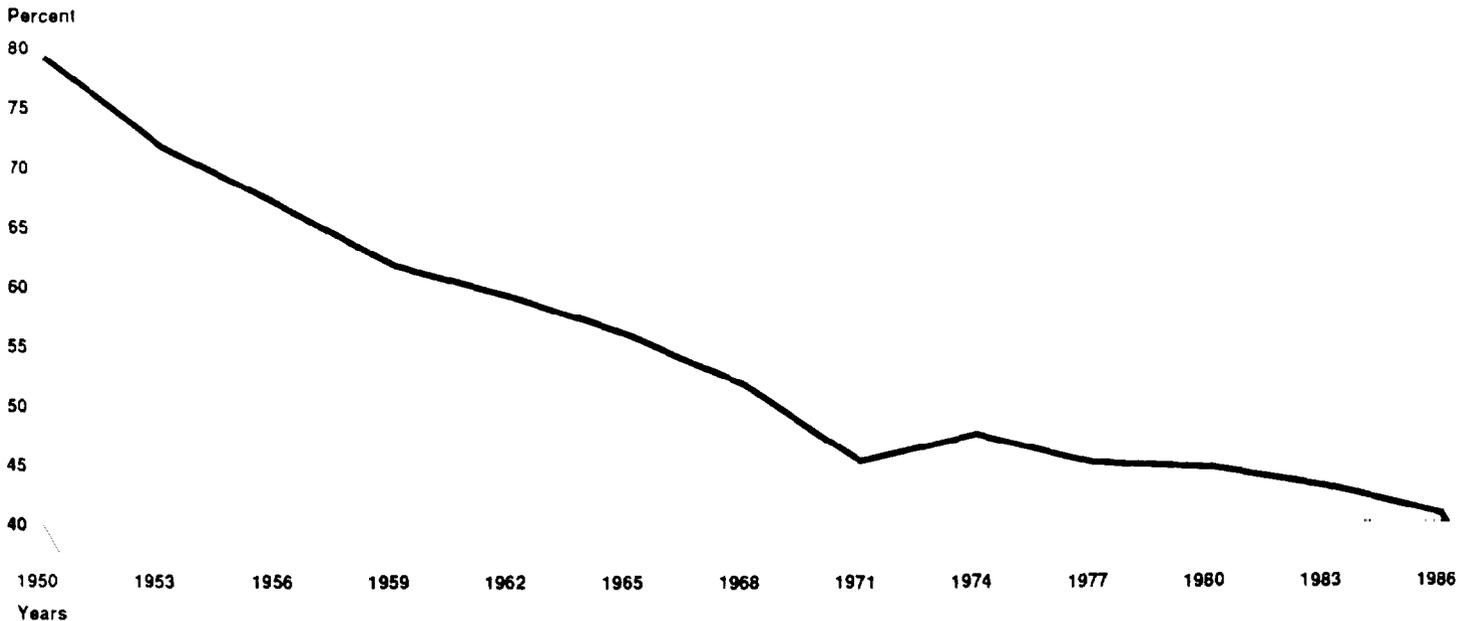
Table 2.3: Average Annual State UI Tax Rates on Taxable and Total System Insured Wages (1950-86)

Period	State UI tax rates	
	Taxable wages ^a	Total insured wages ^b
1950-59	1.38	0.96
1960-69	1.93	1.09
1970-79	2.13	1.03
1980-86	2.75	1.16

^aTaxable wages are all wages subject to the state UI payroll tax up to the end of the state taxable wage base.

^bTotal insured wages include all UI taxable wages plus all other wages earned by employees insured by a state UI program.

Figure 2.16: Total UI Taxable Wages as a Proportion of Total System Insured Wages, Selected Years (1950-86)



Interstate Tax Competition May Encourage Lower UI Taxes Without Corresponding Benefit Restraint

Although UI taxes are typically a small proportion of a firm's total labor cost, the regional competition for new investment and jobs may be encouraging states to keep UI taxes as low as possible, as a way to improve a state's general business climate. During prosperous times, states may experience greater pressures to reduce UI taxes without cutting benefits, slowing the accumulation of trust fund reserves. Consequently, these states may be less able to weather increasing trust fund benefit expenditures during ensuing periods of unemployment, and may have to depend on federal loans.

Although very few states have trust fund balances that meet the traditional standards of adequacy, balances tend to be furthest from adequate levels in regions that have experienced lagging economic growth. Thus, state efforts to restore trust fund adequacy across the country may result in greater tax increases and larger benefit reductions in those parts of the country that have recently experienced the least favorable business climate. However, the failure to accumulate reserves may generate a new round of solvency difficulties during the next business cycle.

Lower Proportion of Unemployed Receiving UI Benefits

The proportion of the unemployed who are drawing Unemployment Insurance benefits has declined over the past 35 years, indicating that the UI system is gradually becoming a less effective source of income support for the individual workers experiencing unemployment and a less effective source of countercyclical stabilization for the economy as a whole. In 1952, nearly 55 percent of unemployed civilian workers were receiving UI benefits; by 1980, less than 44 percent were receiving benefits. The fraction of the unemployed who were receiving benefits declined further in the early 1980's, reaching a low of 29 percent in 1984 before rising slightly to 32 percent in 1986. Probably the major contributors to this trend have been demographic changes in the work force and shifts in the national industrial composition. There is evidence, however, that a part of the trend is the result of changes that states have initiated to maintain or restore trust fund solvency.

Factors that appear to explain at least part of the longer term decline in the proportion of the unemployed receiving benefits are national demographic shifts toward a younger and more female work force and a shift in the economy's employment composition from goods to service sector jobs. Other factors that appear to explain the recent acceleration in the decline include a rising incidence of national long-term unemployment, regional unemployment shifts, federal legislative changes, and a decline in the benefit application rate of eligible unemployed. Because many of these factors are working simultaneously, the individual effect of each is difficult to isolate.

In addition, the financial difficulties of many state trust funds, coupled with changes in federal policies regarding loans to these funds, have resulted in many states taking legislative actions to cut benefit costs by reducing the proportion of the unemployed receiving benefits.

Who Receives UI Benefits?

Using the March 1986 Current Population Survey, we compared the characteristics of UI recipients with those of all the unemployed.¹ UI recipients were more likely to be white, male, and older (over 25) and to have been employed previously in manufacturing, and less likely to be from trade, finance, or service sectors than were all unemployed workers (see tables 3.1 and 3.2). Benefit recipients were less likely to come from a poor household or to receive some form of welfare benefits than

¹For a similar analysis of the characteristics of UI recipients and the unemployed, see *Promoting Employment and Maintaining Incomes With Unemployment Insurance*, Congressional Budget Office, March 1985.

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all unemployed persons. Educational levels were broadly similar between the two groups. The characteristics of the unemployed and of UI recipients have not changed significantly since 1979. (See app. V for data on the 1979 unemployed and UI recipients.)

Table 3.1: Characteristics of the Unemployed and of UI Recipients (1985)

Characteristic	Percent distribution of	
	All unemployed persons ^a	UI recipients
Total	100.0^b	100.0^b
Gender:		
Male	56.0	62.1
Female	44.0	37.9
Race:		
White	81.5	86.3
Blacks and others	18.5	13.7
Age:		
16 - 24	30.8	13.4
25 - 54	61.4	75.4
55 and over	7.8	11.2
Highest education:		
Less than high school degree	29.1	25.2
High school degree	43.9	49.5
Some college	27.0	25.3
Annual family income:		
Less than \$10,000	26.0	15.2
\$10,000 - \$19,999	24.9	27.6
\$20,000 - \$39,999	31.4	39.0
\$40,000 or more	17.6	18.3
Welfare reciprocity:		
Food Stamps	14.9	10.4
Housing Assistance	4.4	2.8
Subsidized Lunches	14.0	11.4
Aid to Families with Dependent Children	4.5	1.7
Medicaid	9.5	4.6
Family income below poverty level	33.2	21.6

^aIncludes persons unemployed or receiving UI benefits at some time in 1985

^bFigures may not add to 100 due to rounding.

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Table 3.2: Distribution of the Unemployed and of UI Recipients by Industrial Sector (1985)

Industry of job held longest in 1985	Percent distribution of	
	All unemployed persons ^a	UI recipients
Total	100.0	100.0
Agriculture	3.3	2.8
Mining, transport, and construction	17.0	22.4
Durable manufacturing	11.2	19.6
Nondurable manufacturing	8.6	14.5
Trade and finance ^b	24.1	17.1
Services ^c	21.8	15.9
Public administration	2.0	1.8
No industry reported	12.1	5.8

^aIncludes persons unemployed or receiving UI benefits at some time in 1985.

^bIncludes wholesale, retail trade, and finance.

^cIncludes personal, professional, business, and repair services.

Long-Term Rise in Unemployment, Decline in Proportion of Unemployed Receiving Benefits

Although varying with economic conditions, the rate of civilian unemployment has tended to rise since 1950 (see table 3.3 for definition). Meanwhile, the proportion of the unemployed receiving UI benefits, while also varying with economic conditions, has tended to decline since 1950.

Table 3.3: Definitions of Key Unemployment Rates and Measures of UI Recipients

Measure	Definition
Insured unemployment rate	The number of regular UI benefit claimants divided by the average number of people in UI-covered employment over 4 of the last 6 completed calendar quarters.
Insured unemployed	The number of regular state UI benefit claimants, including recipients on the 1-week waiting period and applicants who are ultimately denied benefits. ^a
Total civilian unemployment rate	The ratio of all active unemployed job seekers, including quits, labor market reentrants, new entrants, and layoffs, to the total civilian labor force.
Total civilian unemployed	The number of all active unemployed job seekers, including all quits, labor market reentrants, new entrants, and layoffs.
Long-term unemployment rate	The number of all active unemployed job seekers looking for work for 27 weeks or more divided by the total civilian labor force.

^aBecause some claimants are ultimately denied benefits and others may be on a 1-week benefit waiting period common to most state programs, the number of insured unemployed is actually larger than the number of regular UI benefit recipients.

The total civilian unemployment rate, while fluctuating with economic conditions, has generally risen in the post-World War II era (see fig. 3.1). During the 1970's and the 1980's through 1986, the annual national unemployment rate averaged 6.2 percent and 8.0 percent, respectively, compared to an average of 4.5 percent during the 1950's and 4.8 percent during the 1960's. As the rate has increased, the proportion of the unemployed receiving UI benefits has declined. The average annual ratio of the insured unemployed to total unemployed during the 1980's through 1986 was about 30 percent below the annual average of the 1950's. The ratio peaked in 1958 at almost 0.55 and hit its historic low of about 0.29 in 1984 (see fig. 3.2).² Other measures of benefit reciprocity indicate a similar trend (see app. VI).

Like total civilian unemployment, the proportion of the unemployed receiving benefits also varies with economic conditions. During downturns, the number of job losers—the group most likely to receive UI benefits—grows, increasing the proportion of the unemployed receiving benefits. During a recovery, the number of job losers declines while the number of labor-force reentrants increases.³ Thus, the proportion of the unemployed receiving benefits typically falls during a recovery.

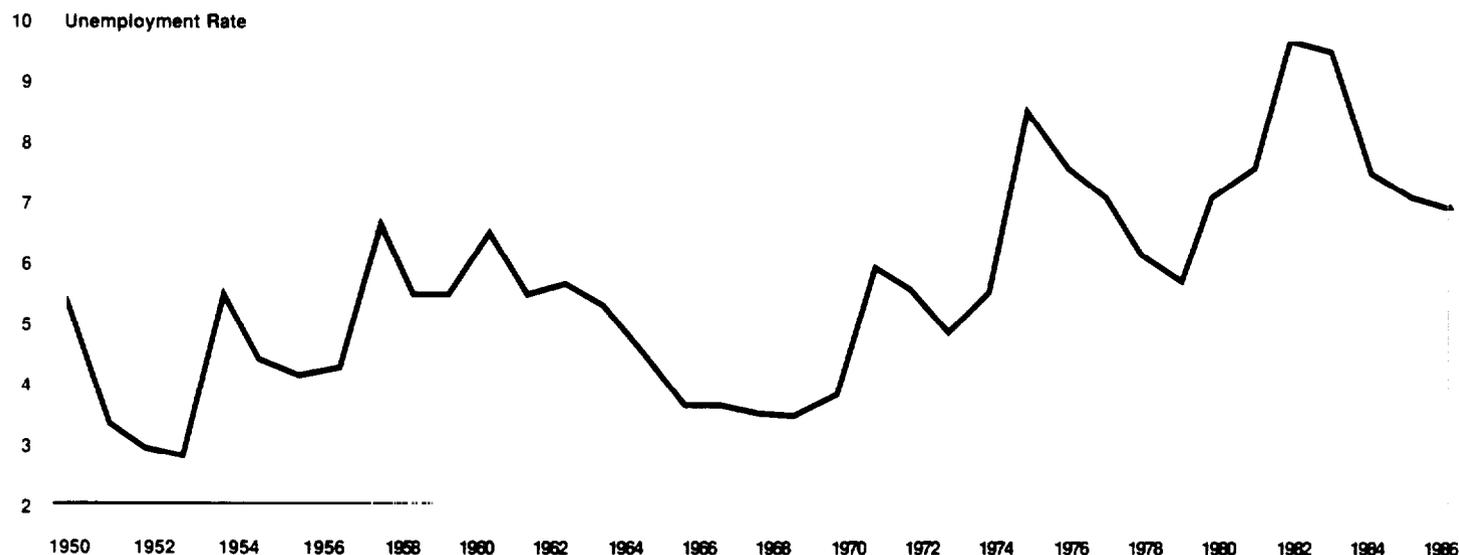
The percentage of the unemployed receiving benefits has declined more dramatically during the 1980's (see fig. 3.3). The average percentage of the unemployed who were UI insured during the 1970's was about 16 percent below the 1950's decade average. However, the ratio dropped about an additional 15 percent between 1980 and 1986 and the 1970's. Recent research supports the conclusion that the decline in the proportion of the unemployed receiving benefits has become larger during the 1980's.⁴

²The insured unemployed includes those receiving regular state UI program benefits but not those receiving assistance from the extended UI benefits program or various temporary supplemental UI programs. Other measures include the ratio of number of benefit claims from all UI programs, including temporary and extended benefits programs, to the number of civilian unemployed, and the ratio of the insured unemployment rate (IUR) to the civilian unemployment rate (TUR).

³Not all unemployed workers receive UI benefits. Workers who either voluntarily quit their jobs without good cause, are fired for misconduct, or do not have sufficient labor market experience are generally ineligible for benefits. Of the four jobless worker groups identified in labor force surveys (labor force reentrants, job losers or people who lost their last job, people who voluntarily quit their last job, and new labor force entrants), job losers are most likely to qualify for UI benefits.

⁴Gary Burtless, "Why is the Insured Unemployment Rate So Low?" *Brookings Papers on Economic Activity*, 1983 #1, pp. 225-254; Wayne Vroman, "The Reagan Administration and Unemployment Insurance," *Urban Institute Discussion Paper*, March 1984, pp. 19-25; and Wayne Vroman and Gary Burtless, "The Performance of Unemployment Insurance Since 1979," *Industrial Relations Research Association Series, Proceedings of the Thirty-Seventh Annual Meeting*, December 28-30, 1984, pp. 138-146.

Figure 3.1: Total Civilian Unemployment Rate (1950-86)



The total civilian unemployment rate is the total number of unemployed divided by the total civilian labor force 16 years of age and over, as reported by the Bureau of Labor Statistics.

Implications of the Decline in UI Reciprocity

The decline in the proportion of the unemployed receiving UI benefits suggests a reduction in the UI system's effectiveness in stabilizing the economy—and in mitigating the effects of income loss suffered by the unemployed. One study found that the decline in regular UI program benefit reciprocity has reduced the anti-recessionary stimulus of the regular UI benefits by over 25 percent.⁵ The decline in reciprocity also appears to have eroded the program's effectiveness in reducing the income loss suffered by the unemployed.⁶

⁵Gary Burtless, *The Adequacy and Countercyclical Effectiveness of the Unemployment Insurance System*, Testimony before the Committee on Ways and Means, U.S. House of Representatives, December 15, 1987, p. 9. Implementing the full taxation of UI benefits and cuts in the federal extended benefit program have further reduced the automatic stabilizing effects of the UI program.

⁶Some analysts have found a strong anti-poverty effect from UI payments. Sheldon Danziger and Peter Gottschalk, *Unemployment Insurance and the Safety Net for the Unemployed*, Institute for Research in Poverty Discussion Paper, University of Wisconsin, Madison, DP# 808-86, August 1986, pp. 18-22. Wayne Vroman, Testimony before the Committee on Ways and Means, U.S. House of Representatives, December 14, 1987, pp. 10-11.

Figure 3.2: Ratio of the Number of the Insured Unemployed to the Total Unemployed (1950-86)



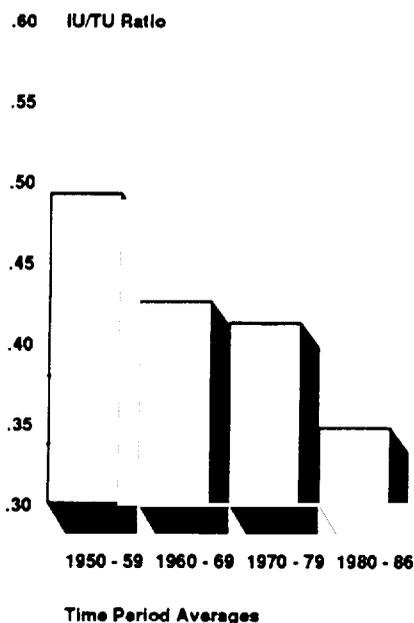
Causes of the Long-Term Decline in UI Reciprocity

There are a number of suggested reasons for the long-term decline in the number of unemployed workers receiving UI benefits. Prominent explanations include (1) shifts in the composition of the labor force toward demographic groups that traditionally have had low rates of benefit reciprocity, such as youth and women, and (2) the national employment shift toward service industries, which traditionally also have had low rates of benefit reciprocity.

A demographic shift toward a younger and more female work force caused at least part of the decline in the proportion of the unemployed receiving benefits since 1950. Compared to adult males, a smaller portion of young and female unemployed qualify for benefits, possibly because they are more likely to have either insufficient earnings or work time to meet state qualifying requirements; are less frequently unemployed as job losers—as opposed to quitting, reentering, or entering the labor market for the first time; or are less likely to apply for benefits as adult men.⁷ Thus, as women and youth make up a larger portion of all unemployed, the proportion of the unemployed receiving benefits declines.

⁷Gary Burtless, pp. 233 and 252-254.

Figure 3.3: Decade Averages of the
 IU/TU Ratio (1950-86)



The IU/TU ratio represents the ratio of the number of UI insured unemployed to the number of total civilian unemployed.

Since 1950, as youth and women increasingly entered the work force and raised their proportion of the total labor force, they accounted for a growing share of the unemployed. The proportion of all unemployed who were younger than 25 years of age rose from about 33 percent in 1950 to 51 percent in 1973. The proportion of the unemployed who were female rose from about 32 percent in 1950 to almost 48 percent in 1973.

The shift in the economy to service and related industries also tends to reduce the proportion of the unemployed receiving benefits because a smaller proportion of unemployed workers in these sectors receive benefits compared to those in other industries.

Since 1950, there has been a steady transition from goods-producing sectors (mining, manufacturing, and construction) to service sectors (including finance and retail sales). Goods-producing industries accounted for 28 percent of all nonagricultural employees in 1980, down from 41 percent in 1950. Service industries increased from 59 percent of the nonagricultural work force in 1950 to over 71 percent in 1980.

One analyst⁸ identified the lower reciprocity rate in service sector employment, although the causes of the lower rate are not well understood. Many service employees have only been covered by unemployment insurance since 1970 (see ch. 1), yet, even after their inclusion, the proportion of the unemployed receiving UI benefits in most service sectors has remained lower than in goods-producing sectors.⁹

The lower rate of benefit reciprocity in the service sector may be due to a greater amount of part-time employment in those industries. In many cases, part-time workers are less likely to qualify for benefits because they cannot meet state earnings requirements for benefit eligibility (see chs. 1 and 4).¹⁰

Additional Explanations for the Accelerated Decline

Demographic and industrial shifts alone cannot explain the accelerated decline in the proportion of the unemployed receiving benefits since 1980. The shift in the composition of the unemployed toward women and the young has not continued since 1980, and the transition to service sector employment does not appear to have accelerated. In addition, the higher proportion of unemployed job losers during much of the 1980's suggests that one should have observed an increase in the proportion of the unemployed receiving benefits. Instead, the ratio has declined.

However, there are other explanations for the accelerated decline since 1980, including the national increase in long-term unemployment—joblessness lasting for 27 weeks or longer (see table 3.3); the continued growth in part-time employment; regional unemployment shifts; federal legislative initiatives, including those that encouraged state programs to tighten eligibility criteria; and other changes in state program administration.

⁸See Burtless, 1983, pp. 233-234. Our analysis of industry UI reciprocity ratios using the 1980 and 1986 CPS data (see app. V) and a 1985 Congressional Budget Office report found similar differences between goods and service industries in the proportion of the unemployed receiving benefits. Congressional Budget Office, p. 9.

⁹The expansion of coverage to new sectors should increase the IU/TU ratio, although it may decrease some other measures of reciprocity, such as the IUR/TUR ratio that Burtless uses (see app. V). However, despite such coverage expansions, the IU/TU ratio has continued its long-term decline.

¹⁰Part-time employment historically has been more common in the service industries, and the growth of these sectors has contributed to the growth of part-time employment. In addition, service sector industries, like retail trade, are increasing their reliance on part-time employees. See *Part-Time Employment: Living on Half Rations*, Sar Levitan and Elizabeth Conway, Center for Social Policy Studies, Washington, D.C., 1988, pp. 3 and 9.

During the early to mid-1980's, the demographic composition of unemployment has moved away from women and youth, reversing earlier trends. Thus, if no other factors were at work, we should have observed a higher UI reciprocity rate during the 1980's, rather than the lower one that occurred.

- The proportion of the unemployed who were males under 25 years of age or women declined from over 74 percent in 1973 to 65 percent in 1986. (See fig. 3.4.)
- The 1980 and 1986 March supplement to CPS indicated that only 31 percent of the unemployed in 1985 were 24 years of age and younger, down from 39 percent in 1979.
- The unemployment rate for adult male workers, a group most likely to receive UI benefits, has increased during the 1980's through 1986, both in absolute terms and as a percentage of total unemployment. Unemployment for males 25 and older averaged 5.9 percent between 1980 and 1986, up from 3.6 percent during the 1970's. Adult males made up about 32 percent of the unemployed during the 1980's through 1986, up from 27 percent during the 1970's.

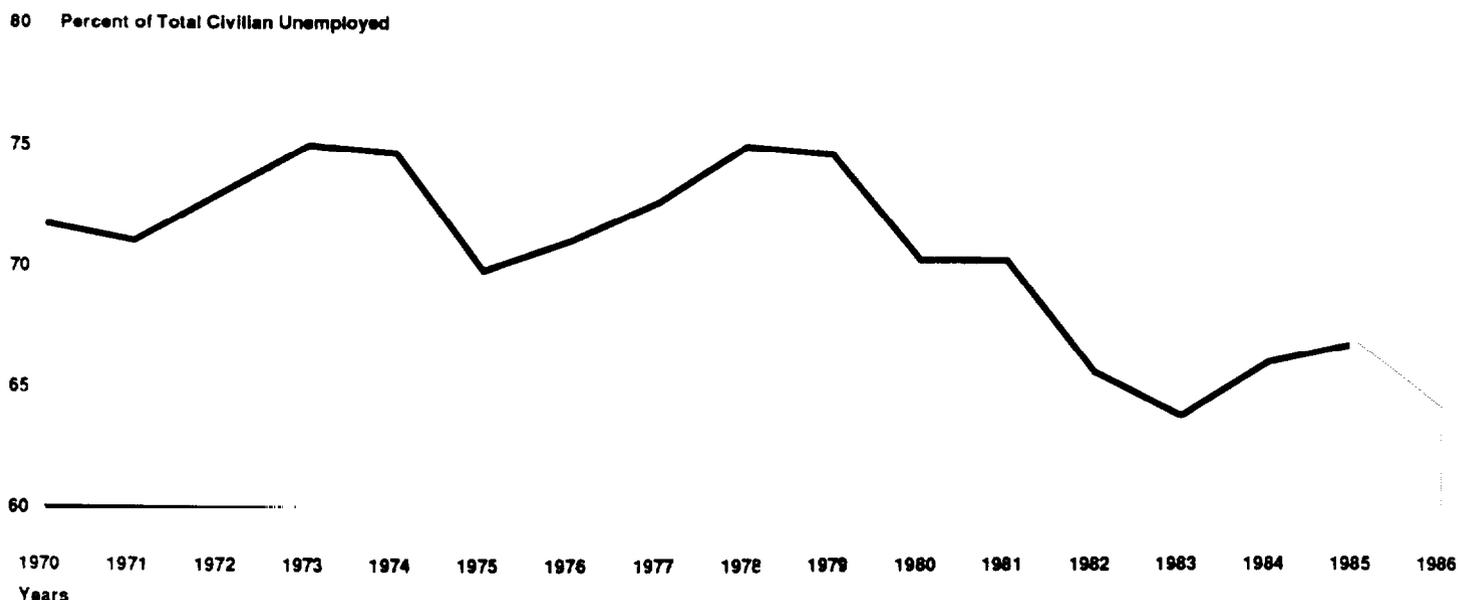
Also, between 1980 and 1986 the industrial shift toward service sector employment appears to have slowed. Between 1970 and 1980, the percentage of all employees on nonagricultural service sector payrolls increased from 66.7 to 71.6 percent, but by 1986 it had only increased to 72.4 percent.¹¹ In addition, the UI system now covers most service sector employees.¹²

With no other changes, the proportion of the unemployed receiving benefits should also have risen during the early and mid-1980's because of the increase in the share of the unemployed who were job losers. The higher total unemployment between 1980 and 1986 compared to past decades included a higher percentage of job losers, the primary source of benefit recipients. Job losers as a percentage of all unemployed workers increased from an annual average of 45 percent during the 1970's to 53 percent between 1980 and 1986. Despite the proportional growth in job losers, the proportion of the unemployed receiving benefits between 1980 and 1986 has declined.

¹¹Service employment is defined as all employment except construction, mining, and manufacturing.

¹²During the 1980's through 1986, there has been some growth in the number of self-employed workers, a group often not covered by UI. However, as of 1986, 88 percent of all employed civilians were still covered by UI.

Figure 3.4: The Proportion of the Unemployed Between 16 and 24 Years of Age or Female (1970-86)



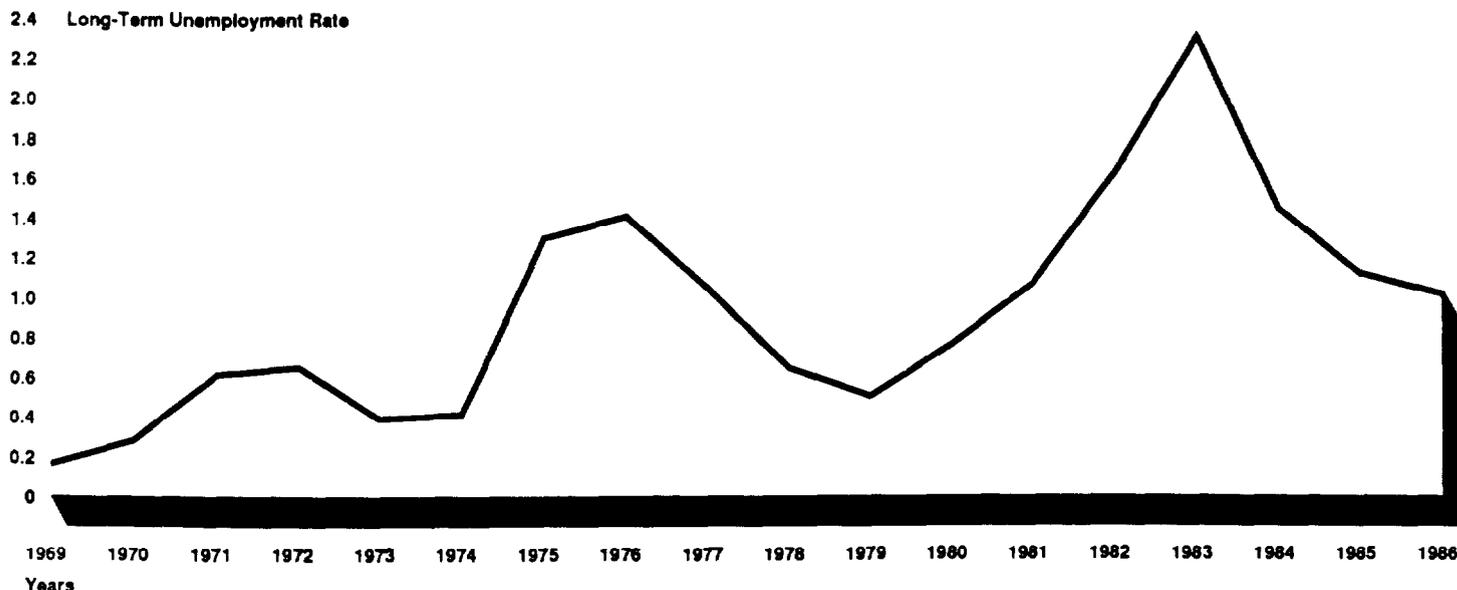
Lower Proportion of the Unemployed Receive Benefits as More UI Claimants Exhaust Benefits

The growth in long-term unemployment has led to an increase in the number of claimants exhausting regular state UI benefits and may have caused a part of the accelerated decline in the proportion of the unemployed receiving benefits.

Long-term unemployment, defined as the number of unemployed people jobless for 27 weeks or more, has increased significantly since 1980 and has stayed relatively high even during the expansion through 1986 (see fig. 3.5). Long-term unemployment has also increased relative to total civilian unemployment; on average, 11 percent of the unemployed were long-term unemployed during the 1970's, compared to 16.3 percent between 1980 and 1986.

By increasing the number of persons who exhausted their benefits, a rise in the number of long-term unemployed reduces the proportion of the unemployed receiving benefits. UI benefit exhaustion rates have risen over time (see fig. 3.6). Between 1980 and 1986, exhaustees as a

Figure 3.5: Long-Term Unemployment Rate (1969-86)



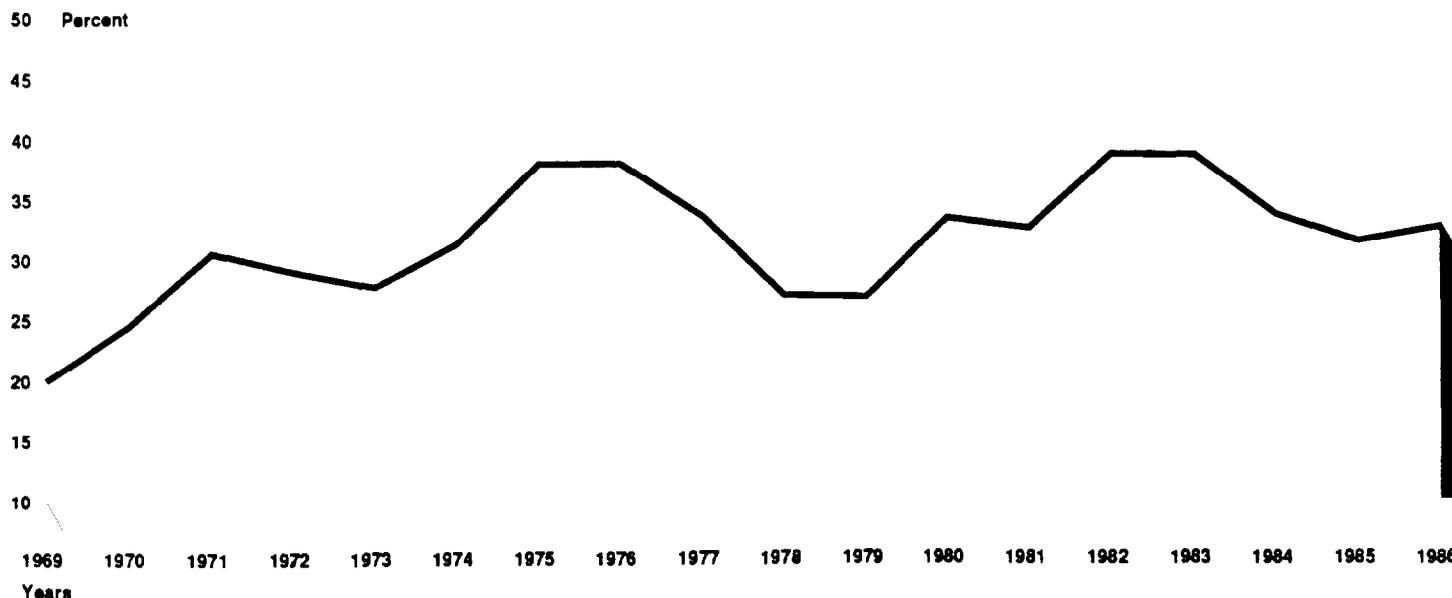
The long term unemployment rate is the number of people unemployed for more than 27 weeks divided by the total civilian labor force.

percentage of claimants¹³ rose to an annual average of about 34 percent, compared to 31 percent for the 1970's. A larger number of exhaustees reduces the proportion of the unemployed receiving benefits.¹⁴ This is because regular UI benefit exhaustees are not counted as insured unemployed even though a significant portion of them remain unemployed

¹³Claimants are often measured by the number of first payments, defined as the total number of first unemployment insurance checks issued during the typical 1-year period after claim filing.

¹⁴A UI claimant who is also classified as long-term unemployed would exhaust regular benefits in 51 out of 53 UI program jurisdictions. An increase in total civilian unemployment composed of job losers with longer unemployment spells could also increase the number of UI recipients who exhausted their benefits. This is because some additional claimants in states with nonuniform benefit duration will exhaust benefits, even though they do not receive benefits for 26 weeks and thus are not classified as long-term unemployed.

Figure 3.6: Percentage of Claimants Who Exhausted Benefits as a Percentage of All Claimants Receiving Benefits for the First Time in the Calendar Year (1969-86)



Claimants are defined as the number of first time regular UI benefit payments made during a calendar year, excluding all extended benefit and temporary program payments.

instead of either dropping out of the labor force or finding employment.¹⁵

Continued Growth in Part-Time Employment

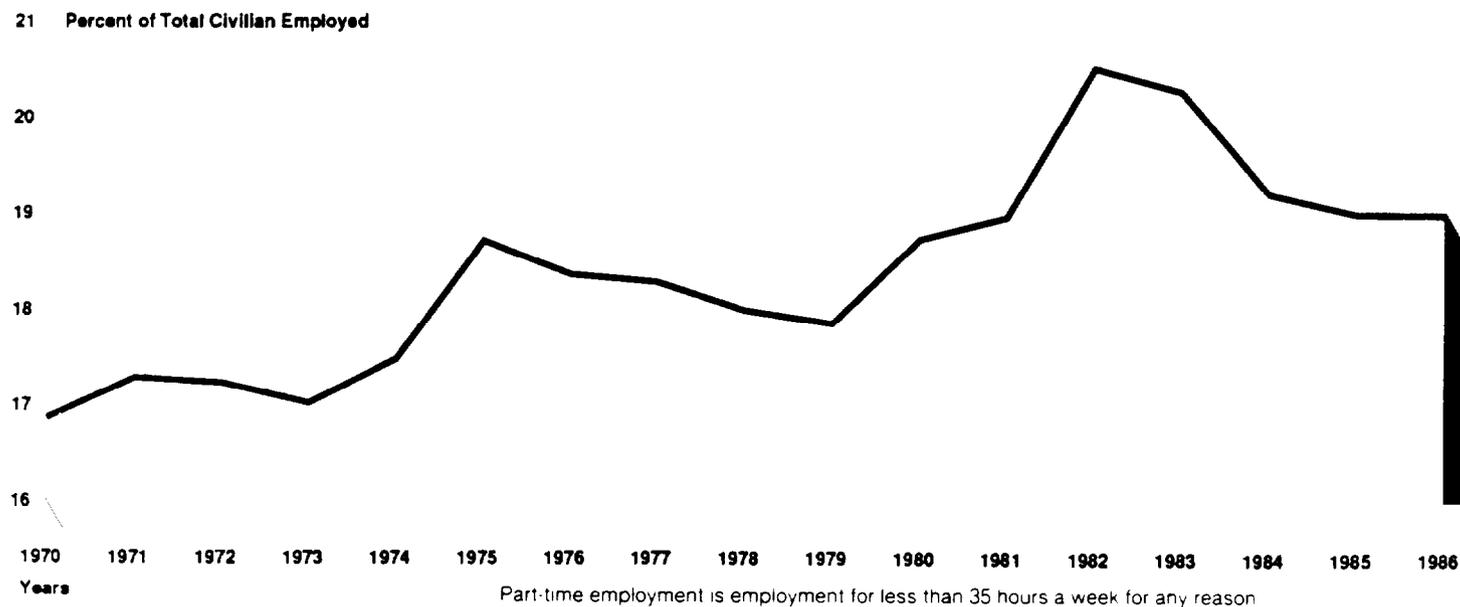
A growing percentage of the work force composed of part-time employees means that more unemployed workers may not meet state earnings requirements for benefit eligibility. In addition, a larger percentage of those claimants who are eligible may receive fewer weeks of benefits.

Since 1970, an increasing part of the employed civilian work force works part time (less than 35 hours per week) (see fig. 3.7). As of 1986,

¹⁵One study found that 4 months after benefit exhaustion, 25 percent of exhaustees had found jobs, 14 percent had left the labor force, and 61 percent remained unemployed. (A Longitudinal Study of Unemployment Insurance Exhaustees, Mathematica Policy Research, ETA Report no. DLMA 11-34-74-01-3 [Jan. 1976], p. 14). Another study found that 24 weeks after exhaustion, 42.2 percent of the exhaustees were employed, 36.7 percent were unemployed, and 21.1 percent were out of the labor force. (Paul Burgess and Jerry Kingston, Labor Market Experiences of UI Exhaustees, Arizona Department of Employment Security [Mar. 1979], p. 18).

20.8 million workers were employed part time either voluntarily or for economic reasons. Between 1980 and 1986, on average, 19.4 percent of the total employed work force was working part time compared to an annual average of 17.7 percent during the 1970's.

Figure 3.7: Growth in Part-Time Employment (1970-86)



Part-time workers are often less likely than full-time workers to qualify for UI in the event of a layoff. One study has found that a minimum wage worker employed for 20 hours a week would not qualify for benefits in 12 states because of minimum monetary eligibility requirements.¹⁶ In states with variable benefit duration, part-time workers may also qualify for fewer weeks of benefits than full-time workers. However, because of the wide variation in state program eligibility criteria, a detailed study of individual state UI laws regarding earnings eligibility standards and the distribution of part-time employment would be necessary to determine the relative significance of this factor.

Regional Unemployment Shifts

One analyst has hypothesized that part of the decline in the ratio of unemployed receiving benefits during the early 1980's has been caused by a shift in national unemployment toward regions where claimants

¹⁶Levitan and Conway, p. 14.

have more difficulty qualifying for benefits.¹⁷ Although unemployment has generally been higher in the Midwest and Northeast during the last 15 years, the shift of population and employment to the South and the West has tended to increase those regions' share of national unemployment. The Southern and Western census regions accounted for 48.5 percent of total national unemployment in 1976, and 52.3 percent in 1984.

Some of the Southern and Western states have had lower insured unemployed to total unemployed ratios than the national average. For example, the percentage of the nation's unemployed in the South Atlantic and West South Central census divisions increased from 20.1 percent in 1979 to 28.6 percent in 1986. The composite regional IU/TU ratios were 29 percent below the national average in 1979 and 11 percent lower in 1986.¹⁸ If national unemployment has shifted toward states where it is more difficult to collect benefits during the 1980's, that could explain the accelerated decline in the percentage of the unemployed receiving UI.¹⁹

Decline in the Benefit Application Rate Caused by Changes in State UI Program Administration

One analyst has also suggested that a portion of the decline in the proportion of the unemployed receiving UI can be explained by a decline in the application rate of eligible unemployed.²⁰ For example, during 1981-82, he calculated that the observed benefit application rate for UI benefits was up to 16 percent lower than one would otherwise expect. One explanation for the decline in the number of the unemployed applying for UI benefits is the rise in UI administrative staffing reductions and office closures, which made it harder for the unemployed to file for benefits. Another possible explanation is the enhancement in state UI program automation. Increased computerization may enable UI staff to advise claimants immediately as to their benefits eligibility through on-line computer systems, resulting in claimants leaving the application office rather than filing ineligible claims.

¹⁷Wayne Vroman, "The Reagan Administration and Unemployment Insurance," Urban Institute Discussion Paper, March 1984, p. 18.

¹⁸An examination of annual census regional IU/TU ratios over the last 10 years generally finds that the South Atlantic, West South Central, and Mountain regions are below the national average; the East South Central and Pacific regions near the national average; and other regions above the national average.

¹⁹However, other factors may have increased these regions' IU/TU ratios, and a state-by-state comparison of eligibility, duration, and other UI law provisions would be necessary to show whether benefit eligibility is more stringent in Southern and Western states.

²⁰Gary Burtless, pp. 239-242.

Federal Legislative Developments

Certain federal legislative changes have reduced the proportion of the unemployed receiving benefits. Since 1980, the federal government has eliminated all temporary UI benefit programs; modified the trigger mechanism of the permanent extended UI benefits program, making it more difficult for states to trigger it into operation; and legislated other changes that would reduce the number of unemployed receiving regular or extended UI benefits.

Eliminating federal supplemental UI benefits and curtailing extended benefits reduce the number of unemployed receiving any UI benefits.²¹ Several other federal legislative modifications possibly influencing the number of unemployed receiving UI include the taxation of UI benefits and the offsetting of certain pensions against the UI benefit amounts received.²²

Finally, as explained in chapter 4, post-1980 federal policies of charging interest on loans to insolvent state trust funds and levying penalty taxes on employers in states with delinquent loans increased the costs of insolvency to state trust funds and encouraged states to take legislative actions reducing benefit costs. These actions have also contributed to the declining proportion of the unemployed receiving benefits.

²¹Some analysts argue that cutbacks in supplemental and extended benefits may also reduce the number of unemployed receiving regular benefits because they reduce the maximum duration a claimant may receive UI benefits. Such a reduction may force claimants to expedite or intensify their search for new employment. Successful job search would reduce the duration of the average covered unemployment spell and thus reduce the ratio of the insured unemployed to the total unemployed. See J.J. McCall, "Economics of Information and Job Search," *Quarterly Journal of Economics*, Volume 84, Feb. 1970; and Reuben Gronau, "Information and Frictional Unemployment," *American Economic Review*, Volume 61, June 1971. One study of this effect estimated that a 10-week reduction in extended benefits generates a 1-week decline in the average spell of insured or regular UI program unemployment. Robert Moffitt and Walter Nicholson, "The Effect of Unemployment Insurance on Unemployment: The Case of Federal Supplemental Benefits," *Review of Economics and Statistics*, Vol. 64, Feb. 1982, pp. 1-11. However, during periods of high unemployment, the unemployed may already be intensively searching for jobs and may not be able to intensify search efforts further in response to a reduction in benefit duration. See William Cooke, "The Behavior of Unemployment Insurance Recipients Under Adverse Market Conditions," *Industrial and Labor Relations Review*, Volume 34, April 1981, pp. 386-95. In this case, the impact of a benefit amount or duration reduction would be smaller.

²²The federal government now taxes UI benefits as ordinary income. If a tax-induced reduction in total benefits deters UI benefit applications from otherwise eligible unemployed claimants, this policy reduces the proportion of the unemployed receiving benefits. Under federal law, states must also offset benefits by the proportion of a claimant's work-related pensions due to the claimant's employer contributions. If this law has reduced the number of benefit claims filed by older unemployed, it has lowered the proportion of the unemployed receiving benefits. Gary Burtless, December 1987, p. 11. However, because the proportion of all unemployed over 55 years of age is small, totaling only 7.8 percent of all unemployed workers in 1985, the potential effect of this change is limited.

The Federal and State Response to Trust Fund Insolvency

Recent federal policy changes have affected both state trust fund solvency and the proportion of the unemployed receiving UI benefits. In many instances, the federal policy changes, by levying interest on certain federal loans and reducing employer tax credits, increased the costs of borrowing to state funds. In response, insolvent trust fund states either raised UI taxes, reduced benefits, or both. While these state actions have reduced the number of states with insolvent trust funds, they have not resulted in most trust funds' accumulating reserves sufficient to meet benefit obligations during future recessions without becoming insolvent.

State efforts to reduce benefit costs often reduced the proportion of the unemployed receiving benefits. In case studies of five states with weak or insolvent trust funds, we found that, in addition to tax increases, all five had modified their UI laws to reduce benefit costs in ways that cut the proportion of the unemployed receiving benefits. We also found that, between 1979 and 1986, in five other states that have faced chronic insolvency problems, the decline in the proportion of the unemployed receiving benefits was much larger than the average decline experienced by all states. However, despite these actions to improve trust fund solvency, none of the funds have accumulated reserves considered adequate as measured by the 1.5 High Cost Multiple standard.

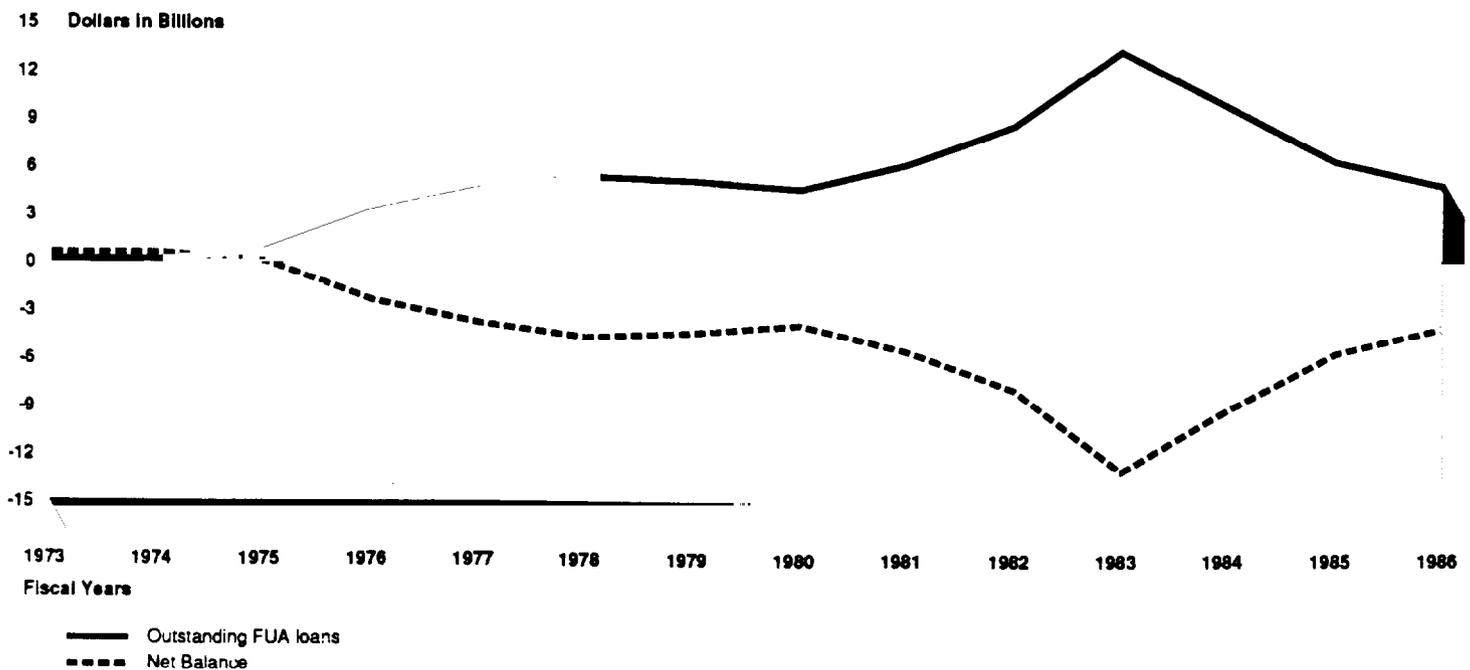
Federal Policy Toward Trust Fund Insolvency

Insolvent state trust funds are eligible to borrow from the Federal Unemployment Account (FUA) to meet their benefit obligations. The Department of the Treasury disburses the loans like a credit line, monitoring the borrowing state's daily trust fund balance and depositing funds when the balance is negative. Under current law, states have from 22 to 34 months to repay the principal and any accrued interest without additional penalty. When a loan is not repaid within the prescribed timetable, repayment delinquency occurs and penalties are assessed. These penalties are levied in the form of three graduated reductions in the federal unemployment tax credit to employers (a tax increase) of at least 0.3 percent annually until the state's loan is repaid.

Since 1974, state trust funds have borrowed almost \$30 billion in federal funds. Heavy borrowing during the mid 1970's and early 1980's exhausted FUA's resources (see fig. 4.1), requiring it to obtain general revenue transfers of more than \$14 billion. Strong loan demand into the 1980's pushed FUA further into deficit. The account reached its largest negative net balance—\$13 billion—in fiscal year 1983. Although the

economic recovery has allowed many trust funds to reduce their outstanding loans, FUA's fiscal year 1987 net balance was about -\$2.3 billion.¹

Figure 4.1: Status of FUA—Net Balance and Outstanding Loans (Fiscal Years 1973-86)



Definition of fiscal year modified in 1976.

Net Balance is defined as FUA's end of the year balance minus all outstanding general revenue transfers.

Federal Policy Shifts Have Increased Costs of Insolvency

During the 1980's, the federal government initiated policies that increased the borrowing costs of state trust funds and provided greater incentives for trust funds to repay outstanding federal loans. These policies included levying interest on federal loans, enforcing employer tax

¹Recent legislation will further reduce this deficit. In December 1987, the Congress approved legislation extending through 1990 the temporary 0.2-percent federal unemployment tax slated to expire in 1988 and allocating a portion of the tax to FUA. In addition, the Congress increased the revenue ceiling of FUA—the maximum amount of revenue FUA can contain—to 0.625 percent of total covered wages.

penalties in delinquent loan states, and enacting financial incentives for states to increase UI taxes and reduce benefit costs.

During the 1970's, federal UI loan policy allowed insolvent state trust funds to repay their federal loans slowly or not at all. The Congress deferred or waived the "penalty taxes" on employers in states with delinquent trust fund loans (see ch. 1). To mitigate the impact of large benefit expenditures, caused by high unemployment, experienced by many debtor states, the Congress enacted legislation that permitted states to delay loan repayment without being liable for any penalty taxes if they met certain tax structure criteria or actually repaid a portion of the loan.²

Delinquent loan states were also able to defer the penalty taxes relatively easily. Between 1975 and 1979, all 19 states with delinquent FUA loans received a penalty tax deferral of at least 1 year, and most received multiple year deferrals.³

During the 1970's and early 1980's, federal loans to state trust funds were also interest free. Compared to the interest paid on positive UI trust fund balances, the noncharging of interest on loans to insolvent funds, especially in an inflationary environment, essentially represented a subsidy to debtor states because states could repay loans in devalued dollars with no compensating interest charges.⁴

The consequence of deferring penalty taxes and interest-free loans coupled with the financial difficulties of many state funds resulted in slow repayment of federal loans. By fiscal year 1982, state trust funds had repaid only about a quarter of all outstanding loans made since 1971.

The Congress let the relatively lenient conditions for postponing the employer tax credit reductions expire in 1980, resulting in significant increases in penalty tax revenue to FUA. FUA's revenue from reduced employer tax credits increased from \$59.4 million in fiscal year 1980 to

²Between 1975 and 1979, the Congress allowed states with delinquent FUA loans to defer the reduction in the federal UI tax credit if, among other conditions, the state maintained or increased UI taxes at certain specified standards, or repaid a portion of its FUA loan while continuing to meet benefit obligations.

³Although 19 state trust funds that borrowed FUA funds during the 1970's were liable for reduced employer tax credits, only 7 suffered any reduction and each only for a single year. The seven states were Connecticut (1974), Washington (1976), Vermont (1976), the District of Columbia (1977), Rhode Island (1978), Delaware (1979), and Pennsylvania (1979).

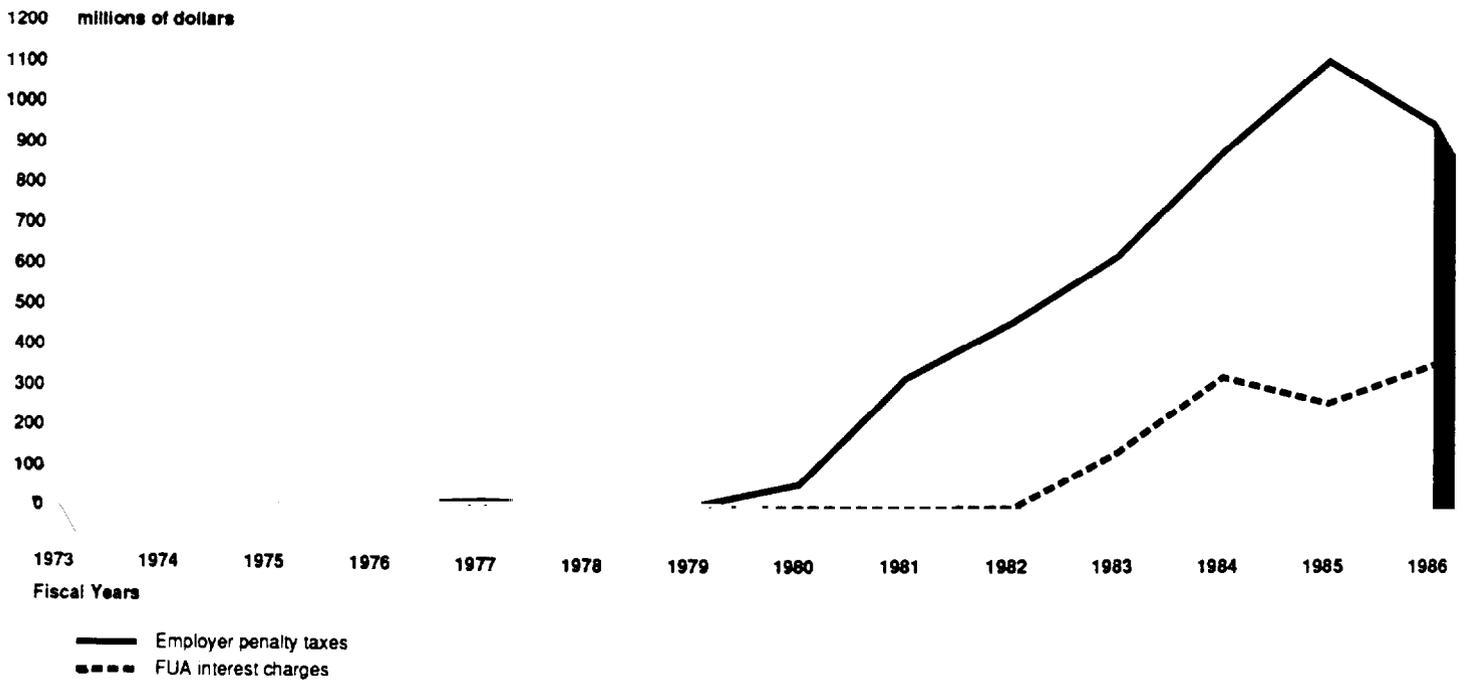
⁴The National Commission on Unemployment Compensation, Final Report, July 1980, p. 97.

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\$1.1 billion in fiscal year 1985, compared to a total of \$34 million in fiscal years 1970-79.

In 1981, the Congress also approved the charging of interest, up to a 10-percent ceiling, on all loans made to insolvent state trust funds after March 31, 1982, if the loan was not repaid in the same fiscal year as borrowed.⁵ Heavy borrowing and high unemployment during the early 1980's quickly generated significant interest charges, totaling over \$1.1 billion between fiscal year 1982 and fiscal year 1986 (see fig. 4.2).

Figure 4.2: Reduced Employer Tax Credit Collections and FUA Interest Rate Charges (Fiscal Years 1973-86)



FUA interest charges accrue to the General Fund.

⁵These changes reduced but did not eliminate the subsidy to debtor states. The interest charged on trust fund loans was still less than that paid by the Treasury on positive trust fund reserve balances, and loans borrowed and repaid during the same fiscal year incurred no interest charges at all. Interest on positive trust fund balances was paid on a quarterly compounded basis, and the rate was not capped at any level. The interest rate on loans held longer than a year and paid once annually on a noncompounded basis was capped at 10 percent, although the cap was not hit in 1984, or in 1986 through 1988.

Interest charges and the tax credit reduction (penalty taxes) provided strong incentives for insolvent state trust funds to expedite loan repayment. Voluntary repayments grew from \$362 million in fiscal year 1982 to almost \$2.6 billion in fiscal year 1983, a seven-fold increase. During the 3-year period fiscal years 1983-85 alone, state trust funds repaid over \$16.0 billion in FUA loans (see fig. 4.3).

In the 1983 Social Security Amendments and other laws, the Congress chose to address jointly both the reserve or revenue side and the benefits side of the solvency issue by providing financial incentives for states to regain trust fund solvency. The Congress allowed states that made progress toward restoring trust fund solvency to receive FUA loan interest deferrals, discounted FUA loan interest rates, and partial freezes on employer tax credit reductions. To qualify for many of these incentives, states had to amend their UI laws to improve program solvency by both raising UI taxes and reducing benefit costs.⁶ States generally had to requalify annually for financial relief, having to maintain previously enacted cost-reducing and tax-increasing actions as well as initiating new steps to retain qualification.⁷

At least seven state trust funds annually qualified between 1983-85 for one or more of the solvency incentives (see table 4.1). Five of these states approved state solvency legislation, increasing state trust fund revenues by an average of \$1.5 billion over the 4-year period 1983-86.⁸

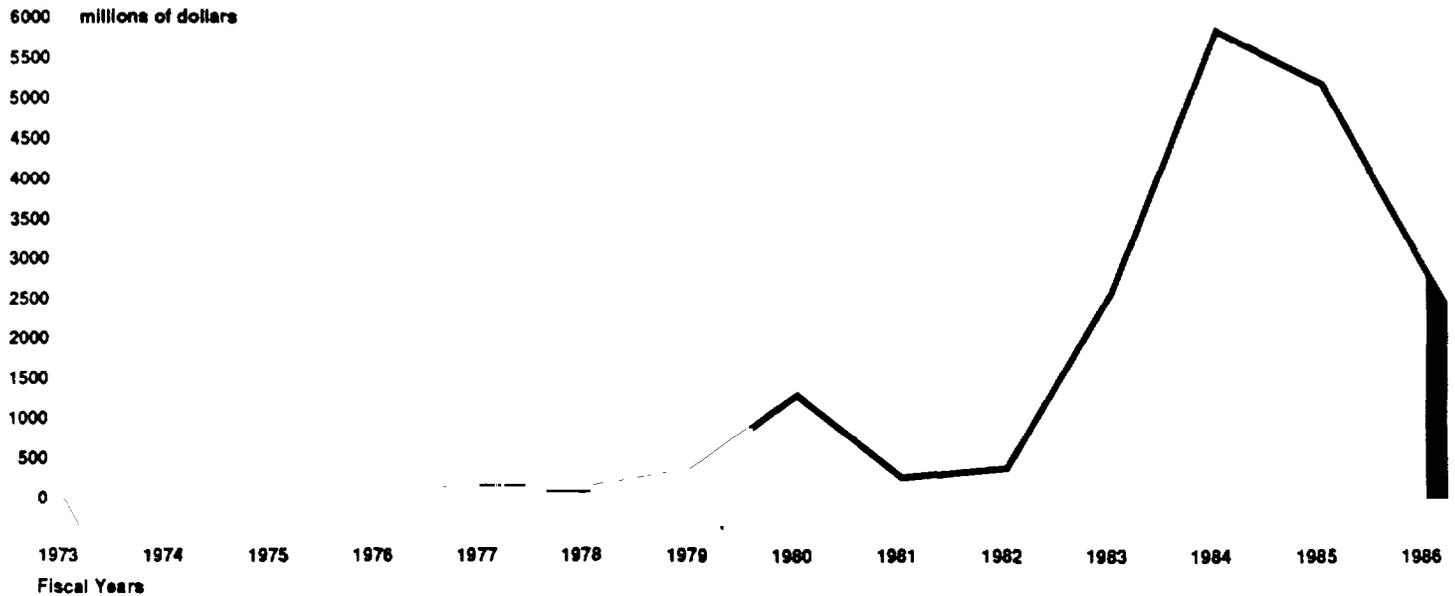
⁶Previously, the Omnibus Budget Reconciliation Act of 1981 had included solvency incentives that effectively required states to legislate improvements in trust fund solvency and meet other specified conditions. These provisions expired at the end of fiscal year 1985. Under the Tax Equity and Fiscal Responsibility Act of 1982 and the Social Security Amendments of 1983, states could also receive other interest deferrals if their insured or civilian unemployment rates exceeded specified levels. These deferrals are permanent.

⁷See chapter 2 of Vroman (1986) for a discussion of states that modified their UI laws during the 1980's.

⁸The five states were Pennsylvania (\$1.9 billion), Illinois (\$1.4 billion), Michigan (\$2.5 billion), Ohio (\$0.9 billion), and Wisconsin (\$0.8 billion). See Vroman (1986), p. 111.

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Figure 4.3: Voluntary FUA Loan Repayments (Fiscal Years 1973-86)



Voluntary FUA loan repayments do not include employer penalty taxes.

Table 4.1: Number of States Qualifying for Legislative Action Solvency Incentives (1983-85^a)

	1983	1984	1985
Interest deferral ^b	9	9	6
Interest discount	5	3	3
Partial employer tax credit reduction	3	7	4
Total states qualifying for at least one incentive	9	10	7

^aBetween 1983 and 1985, 12 states—Colorado, the District of Columbia, Illinois, Kentucky, Michigan, Minnesota, Montana, North Dakota, Ohio, Pennsylvania, West Virginia, and Wisconsin—qualified for the interest rate incentives and the partial employer tax credit reduction cap. States had to meet certain conditions regarding trust fund solvency to qualify for these incentives. Qualifications for interest deferrals required combined increases in state solvency efforts—revenue increases and benefit cuts—totaling 25 percent during the first year of qualification and at least 35 and 50 percent during later years. Discounted interest rates required combined solvency improvements of at least 50 percent during the first year and 80 and 90 percent during ensuing years. States could also receive partial caps on employer tax credit reductions if they maintained tax and solvency efforts, reduced outstanding loans, and maintained tax rates at specified levels.

^bThis category includes West Virginia, which qualified for the average tax rate interest rate deferral between 1983 and 1985. States qualified for this incentive by maintaining their solvency effort and maintaining 1982 UI tax revenue at at least 2 percent of total state insured payroll.

The State Response to Trust Fund Insolvency

During the 1980's, states raised UI taxes or reduced benefit costs and in many instances did both. Although state efforts to increase taxes and reduce benefit costs have improved trust fund solvency since 1983, most states have not accumulated adequate reserves.

In addition, some of the state efforts to cut benefit costs have reduced the proportion of the unemployed receiving benefits. In legislative case studies of five states with financially weak trust funds during the past 6 years, all five increased UI taxes and reduced benefit costs in ways that reduced the proportion of the unemployed receiving benefits.

We were unable to determine the magnitude of this decline either for individual states or for the nation as a whole.⁹ However, state trust funds that have experienced considerable insolvency, and therefore would be more affected by federal solvency policy, appear to show larger-than-average declines in the proportion of the unemployed receiving benefits. We found that between 1979 and 1986, the proportion of the unemployed receiving benefits in five chronically insolvent states that took legislative action declined by more than the national average.

State Legislative Action Reduces Insolvency, Reserves Still Inadequate

Although state efforts to increase taxes and reduce benefit costs have improved trust fund solvency since 1983, most states have not accumulated adequate state trust fund reserves. As of the end of 1986, none of the 31 trust funds that had been insolvent at least once since 1972 had accumulated reserves sufficient to meet the 1.5 standard of financial adequacy. Examining all trust funds, we found that only two—Mississippi's and South Dakota's—exceeded the 1.5 standard at the end of 1986.

Using the 1.0 High Cost Multiple standard for financial adequacy, we detected a similar pattern. Three state trust funds surpassed the 1.0 standard in 1982 as did two in 1983. As of the end of 1986, only 11 trust funds exceeded the 1.0 standard. Of these, only three states—Alabama,

⁹A preliminary study by Mathematica may shed further light on this issue. Despite some statistical constraints, Mathematica estimated that changes in state UI laws and administrative practices accounted for between 30 and 40 percent of the decline in the UI claims ratio between 1980 and 1986. The impact of state laws and administrative practices was largest and most statistically significant in the 11 largest states. See *An Examination of Declining UI Claims During the 1980's*, Mathematica Policy Research, Inc., P.O. Box 2393, Princeton, New Jersey. Draft, May 1988, pp. IX-X.

Hawaii, and the Virgin Islands—had experienced trust fund insolvency since 1971.¹⁰

Benefit Cuts Have Reduced the Proportion of the Unemployed Receiving Benefits

State UI provisions reducing maximum benefit duration and increasing monetary eligibility standards and disqualification penalties have contributed to a declining proportion of the unemployed receiving benefits.¹¹

Some states reduced the proportion of the unemployed receiving benefits by cutting the maximum potential benefit duration available to claimants. Receiving fewer weeks of UI benefits, some claimants with long periods of unemployment will now exhaust benefits. Since exhaustees are not counted among the insured unemployed, although many of them will remain jobless (see ch. 3), a reduction in maximum potential benefit duration lowers the percentage of the unemployed receiving UI benefits. Between 1980 and 1987, seven states with a maximum benefit duration longer than 26 weeks reduced their maximum duration to 26 weeks.¹²

During the 1980's, many states have also made it more difficult to qualify for benefits. All states require that claimants have minimum earnings levels, a minimum number of weeks worked, or some combination of earnings and employment duration to qualify for UI benefits. Fewer unemployed workers will qualify for benefits and the proportion of the unemployed receiving benefits is reduced when the amount of earnings or length of work time necessary to qualify for benefits is increased, or when the state imposes a more restrictive distributional formula on a

¹⁰The Maryland trust fund also recovered from insolvency during the 1970's to exceed the 1.0 standard in 1980 and 1981. However, Maryland had a High Cost Multiple of 0.86 at the end of 1986.

¹¹We identified five state trust funds—Louisiana, Wisconsin, Ohio, West Virginia, and South Dakota—that, as of January 1987, had frozen their minimum or maximum benefit levels or both at least until 1988. States may reduce the proportion of the unemployed receiving benefits by freezing or reducing the maximum weekly benefit amount, if such reductions lower claimants' unemployment duration. Some analysts argue that less generous benefits intensify the unemployed's job search, expediting reemployment. This would decrease the number of both the insured and total unemployed, cutting the insured unemployed to total unemployed ratio. However, at high unemployment levels, intensified job search may not result in expedited reemployment (see ch. 3).

¹²The states providing a maximum uniform benefit duration longer than 26 weeks in 1981 were the District of Columbia, Louisiana, Massachusetts, Pennsylvania, Utah, Washington, West Virginia, and Wisconsin. Alaska reduced its maximum benefit duration from 28 to 26 weeks in 1980. As of 1987, only Massachusetts and Washington still provided a maximum benefit duration longer than 26 weeks.

claimant's prior year earnings.¹³ For example, a state may require a minimum earnings total during a 1-year period to qualify for benefits, with the added requirement that total annual earnings be equal to 1.5 times the earnings in the highest 3-month period during that year. Between January 1981 and January 1987, 35 states increased the earnings level required for the minimum weekly benefit amount, and 18 changed their earnings distribution formula in such a way as to reduce the number of unemployed eligible for benefits.¹⁴

All states disqualify benefit claimants who quit their jobs without just cause, were fired for misconduct, or refused suitable employment, although the definition of these disqualifications varies across states. Penalties for claimant disqualification often specify a duration of benefit ineligibility and an additional earnings requirement for requalification. In certain cases, penalties include the reduction or cancellation of benefit rights. Increasing these penalties makes it more difficult for disqualified claimants to become reeligible for benefits. Between 1981 and 1987, 19 states increased penalties for voluntary leaving disqualifications; 22, for misconduct or gross misconduct disqualifications; and 20, for refusing suitable work while unemployed (see table 4.2).¹⁵ These actions further limit the access to unemployment benefits and contribute to the reduction in the proportion of the unemployed receiving benefits.

¹³It is more difficult to qualify for benefits when states increase the total amount of pre-unemployment earnings or minimum work time necessary for claimants to qualify for minimum benefits, although statewide growth in the average weekly wage would mitigate the impact of increases in the earnings requirement. States can also vary the monetary qualifications standard by increasing the types of income that are disqualified for benefit determination. Disqualified income can include such items as severance and dismissal pay and workers' compensation payments.

¹⁴Some state programs with nonuniform benefit duration—states where both a claimant's weekly benefits and benefit duration are adjusted according to the claimant's pre-unemployment earnings distribution and the amount of earnings and work—have tightened eligibility standards for maximum weekly benefit duration. Tightening benefit duration requirements reduces a claimant's potential number of benefit weeks or benefit duration, which reduces the insured unemployed to total unemployed ratio if a claimant's unemployment spell is longer than the potential benefit duration. Because benefit duration formulas interact with weekly benefit formulas in these states, each program must be individually examined for its impact on the insured unemployed to total unemployed ratio.

¹⁵The impact of changes in disqualification penalties also depends on individual states' definition of disqualifications and the degree of flexibility in interpreting them. We did not examine variations in the state definitions of disqualifications or the differences in state administrative determination processes.

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Table 4.2: UI Benefit Cost Reductions in Insolvent and All Jurisdictions (Jan. 1981-Jan. 1987)

Category	Actions (1981-87)	
	All states	Insolvent states ^a
Reducing maximum benefit duration	7 ^b	5
Increasing monetary eligibility standards for minimum benefits	35	15
Tightening monetary eligibility requirement formulas	18	9
Increasing disqualification penalties:		
Voluntary leaving	19	13
Misconduct and gross misconduct	22	11
Failure to accept suitable work	20	9
Enacting at least one of the above actions	44	22 ^c

^aBetween 1980 and 1986, 25 trust funds were insolvent (had loans larger than reserves at the end of the calendar year) at least once.

^bIncludes Alaska, which reduced maximum benefit duration in late 1980.

^cIn addition, 6 other states which borrowed federal funds but had positive balances at the end of the calendar year enacted at least one of the provisions, increasing the total to 28 states

Most jurisdictions that enacted at least one of these provisions experienced financial difficulties. Between 1981 and 1987, 44 jurisdictions either reduced maximum benefit duration, tightened eligibility requirements, or increased benefit disqualification penalties. Of these 44 jurisdictions, 28 had borrowed federal funds at least once, of which 22 were insolvent for at least a year during the period.

This suggests that such changes were at least partially enacted to improve state trust fund solvency. During the 1980's, states with insolvent trust funds also tended to exhibit a greater decline in the proportion of the unemployed receiving benefits. Between 1979 and 1986, the average ratio of the number of insured unemployed to the total number of unemployed in five "chronically" insolvent states dropped over 31 percent, while the national average fell by only about 23 percent.¹⁶ Each of these states also enacted provisions during the 1980's that contributed to the reduction in the proportion of the unemployed receiving benefits.¹⁷

¹⁶The five states were Illinois, Michigan, Pennsylvania, Ohio, and West Virginia. All five had continuously insolvent trust funds between 1980 and 1986.

¹⁷See Vroman (1986), p. 114.

Chapter 4
The Federal and State Response to Trust
Fund Insolvency

Given the current inadequate reserve levels in many states, the next recession could result in another round of state benefit cuts, reducing the proportion of the unemployed receiving benefits.

Table 4.3: Financial Status of Case Study Trust Funds (1981 and 1986)

State	Net reserves		High Cost Multiple	
	1981	1986	1981	1986
	Colorado	+\$94	+\$83	0.45
Louisiana	+210	-787	0.51	^a
Oklahoma	+213	+69	1.02	0.31
Texas	+254	-366	0.31	^a
Wyoming	+72	+37	0.98	0.47

^aTrust fund insolvent.

Table 4.4: Case Study State Actions Affecting the Proportion of the Unemployed Receiving Benefits (1981-86)

Benefit action	State				
	Colorado	Louisiana	Oklahoma	Texas	Wyoming
Monetary eligibility standards increased	X	X	X		X
Disqualification penalties tightened				X	X
Maximum benefit duration reduced		X			
Pension offset expanded					X
Benefit duration formula tightened		X	X		

build adequate reserves to avoid future borrowing rather than simply encouraging them to repay loans.

One option, consistent with current program mechanisms, would be to establish a standard for the level of reserves to be maintained by state UI trust funds. The implementation of such a standard could include a grace period for compliance based on variations in state economic conditions and could be buttressed by financial incentives. The standard could also be enforced by a mechanism analogous to the reduced tax credits (or increased taxes) currently levied on employers in states with delinquent trust fund loans. Thus, employers in states whose trust funds failed to meet the reserve level requirement would incur a reduction in the federal UI tax credit. Revenues from the tax credit reduction would be deposited into the state trust fund until the reserve balance standard was met.

However, because current policy regarding federal lending to state trust funds has had the effect of encouraging an erosion of benefits to many workers, the Congress may wish to craft any measure to improve reserve adequacy in a manner that does not further erode benefit eligibility.

Another related consideration is that the financial health of state trust funds varies, in part, because of differences in the patterns of regional economic activity. The Congress may wish to consider program changes that would help offset the fiscal burden that falls on states with chronically high unemployment rates. For example, the federal UI tax could be increased somewhat, and the additional proceeds used to aid states with particularly severe unemployment conditions.

Agency Comments and Our Evaluation

The Department of Labor's comments (see app. X) focused primarily on congressional consideration of a reserve adequacy standard. During recent testimony on this topic,¹ Labor generally agreed with our analysis of the decline in trust fund reserve adequacy, and in its comments, it acknowledged the potential threat to state trust fund solvency posed by future recessions. Labor nonetheless believes that a reserve adequacy standard is both unnecessary and infeasible. In its view, the availability of federal loans provides sufficient protection to financially troubled or

¹Department of Labor testimony on the Adequacy of UI Trust Fund Reserves, presented before the House Government Operations Subcommittee on Employment and Housing, July 7, 1988.

insolvent trust funds. Existing incentives for prompt state loan repayment, like the levying of interest on loans, encourage trust fund solvency while maintaining state discretion. Labor noted that the current economic expansion, coupled with the UI tax structures of many states that replenish trust fund reserves during high points in the business cycle, has generally improved reserve levels.

Despite the length of the current economic expansion, most states still have inadequate reserves, a condition that, according to projections, may continue well into the next decade. This situation exists because states currently have little incentive to build reserves. The easy availability of federal loans, while a positive feature of the current UI system, permits states to avoid reserve accumulation. This is reinforced by the interstate competition to attract or retain employment. Such competitive forces likely cause some states to hold down UI taxes, further reducing state willingness to build reserves.

Labor's current policy effectively sets a reserve standard of zero. This is because incentives to rebuild reserves are lacking until a state's reserves are exhausted, in which case penalty taxes and interest charges can then be avoided by repaying debt and accumulating positive reserve balances. A workable federal standard would encourage states to accumulate reserves when they are most able to do so, and might also reduce somewhat the competitive pressures that argue for low reserves and reduced benefits.

Labor also contends that establishing a standard is infeasible. In its recent testimony, it cited the statistical and methodological problems associated with devising a reserve standard as so significant that the resulting standard would prove either ineffective in encouraging trust fund reserve accumulation or inequitable in its treatment of different state conditions.

Nonetheless, Labor has used a voluntary solvency guideline of 1.5 times the states' High Cost Multiple in past years, and further research could likely determine whether this standard, or a menu of comparable criteria from which states could choose, would be more effective in encouraging reserve accumulation.

Labor did not discuss issues concerning the proportion of the unemployed receiving benefits because it believes that the decline in trust fund reserve adequacy and the identified decline in the proportion of

the unemployed receiving benefits are not directly related. Labor suggested that we review a Department-commissioned study by Mathematica Policy Research examining the causes of the decline in the proportion of the unemployed receiving benefits.

We have reviewed this report, and our identification of state actions as an important factor in reducing the proportion of the unemployed receiving benefits is consistent with the Mathematica finding that state legislative and administrative actions accounted for 30 to 40 percent of the reduction in the proportion of the unemployed receiving UI benefits between 1980 and 1986.

The Department of Labor Unemployment Insurance Service State Loan Model

The Unemployment Insurance Service (UIS) State Loan Model produces fiscal year estimates of aggregate trust fund balances, loans and repayments, loan balances, reduced federal UI tax credits, interest earnings, and interest paid. State-by-state estimates are also produced, but these are less reliable than the national estimates.

The model first projects trust fund revenues and outlays by fiscal year. Outlays are disaggregated to the state level by using each state's share of recent actual outlays. Trust fund revenues are the product of state taxable wages and the average state UI tax rate. States with indexed taxable wage bases get a growing share of taxable wages. State trust funds with outstanding federal loans are assumed to have average tax rates that decline more slowly than the national average.

Because the seasonal low point of the fund balance occurs approximately at mid-year, state trust fund outlays and revenues are split into half-years. This is performed by using proportions based on national data with trust fund balances then computed for the end of each half-year. If a state's trust fund balance is negative, a federal loan of that amount is assumed. If the balance is positive, simple decision rules are used to determine whether a voluntary loan repayment would be made. Estimated loans and repayments are net amounts for the half-year and do not take account of the monthly cash flows.

The program also simulated the complex workings of the federal UI tax credit reduction provisions. The amount of reduced credits is computed and treated as a loan repayment. Average annual fund balances and loan balances are computed, generally assuming a straight-line path from beginning balance to mid-year balance and from mid-year to ending balance. Projected interest rates are then applied to average balances to estimate interest earnings and interest payments. National estimates for all items are obtained by summing up the estimates for individual states.

Labor Department Projections

We used the forecasts for the fiscal years 1987-92 as performed by Labor in January 1987. Using official administration economic assumptions, the paths of key program variables are projected for the following 5 years. Labor's forecasts were based on the assumption of a 3.5-percent average annual real gross national product growth rate over the 5-year period, above the average rate for the 1970's and 1980's through 1986, and continues the current economic expansion through fiscal year 1992 (see table I.1).

Appendix I
The Department of Labor Unemployment
Insurance Service State Loan Model

Table I.1: Economic Assumptions of the Labor Department UI Trust Fund Projections (Fiscal Years 1987-92)

Fiscal year	Civilian unemployment rate	IUR^a	CPI^b increase	Real GNP^c growth
1986 ^d	7.0%	2.8%	1.2%	2.3%
1987	6.9	2.7	3.5	3.3
1988	6.5	2.5	3.6	3.6
1989	6.2	2.3	3.6	3.6
1990	6.0	2.2	3.1	3.6
1991	5.8	2.1	2.7	3.5
1992	5.6	2.0	2.1	3.3

^aInsured unemployment rate

^bConsumer Price Index.

^cGross National Product.

^dActual figures.

The January 1987 Department of Labor trust fund projections for fiscal years 1987-92 predicted an increase in aggregate net reserves through fiscal year 1990. Aggregate net reserves were forecasted to grow 62 percent—from \$15.6 billion in fiscal year 1986 to \$25.2 billion in fiscal year 1990—before declining slightly afterwards.

Labor forecasted a decline in outstanding trust fund loans from \$4.8 billion in fiscal year 1986 to \$1.6 billion in fiscal year 1992. The number of state funds with outstanding federal loans was projected to decline from seven in fiscal year 1989 to six in fiscal year 1990 and five in fiscal year 1991 and afterwards.

Despite the predicted growth in reserves, trust fund reserve adequacy as measured by the High Cost Multiple showed a slight decline, never approaching acceptable levels of adequacy. The aggregate High Cost Multiple was projected to peak at 0.49 in fiscal year 1989 and averaged 0.45 for the entire period, well below the 1.5 standard or the weaker 1.0 level.

We asked Labor to project the impact on UI system reserves of a recession in fiscal year 1988. Illustrating the system's lack of adequate reserves, a recession in fiscal year 1988 was projected to increase the number of insolvent trust funds significantly. Aggregate net reserves would decrease by \$13.5 billion from fiscal year 1987, with the number of insolvent trust funds projected to increase from 7 at the end of fiscal year 1987 to 17.

Appendix I
The Department of Labor Unemployment
Insurance Service State Loan Model

This scenario assumes an increase in the average annual benefit payout ratio (the ratio of benefits to total program-covered wages) to 1.6 percent from 0.89 percent during fiscal year 1988.¹ Even though the economy is assumed to recover in fiscal year 1989, the projected number of insolvent trust fund states would remain at 17 before declining in later years.

¹Benefit payout ratios—the total level of state UI benefits paid as a percentage of total state UI program covered wages—of 1.6 percent and higher are common during recessions, equaling or exceeding that level during the low point years of five postwar recessions—1949, 1958, 1961, 1975, and 1982.

The Massachusetts State Trust Fund Simulation

We asked Dr. Wayne Vroman of the Urban Institute to construct a model of the Massachusetts state UI trust fund in order to examine the impact of alternative macroeconomic scenarios on the financial adequacy of a trust fund with large positive net reserves. The Unemployment Insurance Simulation Model (UISIM) contains about 70 equations using annual data designed for manipulation on LOTUS software and can be estimated using data from public sources, such as the Labor Department Unemployment Insurance Financial Data, ETA Handbook 394 and updates and the Employment and Earnings and Geographic Profile of Employment and Unemployment periodicals. The specification of each equation can be found in UISIM: A Simulation Model of Unemployment Insurance, Wayne Vroman, April 1987.

The model equations are grouped in particular blocks and, using LOTUS spreadsheet computation capabilities, can be modified or loaded with different data for speedy sensitivity analysis. Block 1 includes primary exogenous variables like total unemployment, interest, inflation, and labor-force growth rates. Block 2 determines annual benefit payments for both the regular UI and the extended benefits program. Block 3 includes the equations determining total UI tax payments, block 4 determines actual trust fund interest payments and annual average trust fund balances, while block 5 contains particular characteristics of the Massachusetts state trust fund.

The unemployment and wage inflation assumptions for the major and moderate recession scenarios are presented in table II.1. UISIM assumes that there is no state legislative response to trust fund insolvency, although it is likely that states will respond legislatively to avoid the accumulation of interest-bearing loans. Dr. Vroman has consulted Dr. Rina Kottcamp of the Massachusetts UI Fund to review UISIM's accuracy and incorporated many of her comments. We did not have available, however, additional simulation results for evaluating the model's historical performance.

Appendix II
The Massachusetts State Trust
Fund Simulation

Table II.1: Economic Assumptions of the Moderate Recession and Major Recession Scenarios (1987-96)

	Major recession		Moderate recession	
	Massachusetts unemployment rate (1970's)	Massachusetts wage inflation rate (1970's)	Unemployment rate	Inflation rate
1987	4.6	5.8	4.1	4.0
1988	6.6	5.6	6.0	4.0
1989	6.4	5.2	6.5	4.0
1990	6.7	5.7	8.3	4.0
1991	7.2	6.2	8.2	4.0
1992	11.2	7.6	6.4	4.0
1993	9.5	5.9	6.1	4.0
1994	8.1	6.2	6.0	4.0
1995	6.1	7.8	5.5	4.0
1996	5.5	7.1	5.1	4.0

Table II.2: Summary of Massachusetts UI Program (1986)

Characteristic	Status/condition
Net trust fund reserves	\$990 million
Tax collections	\$409 million
Benefit payout	\$463 million
High Cost Multiple	0.61
Weekly benefits	\$330 maximum, \$156 average
Maximum benefit amount indexed to average weekly wage	Yes
Maximum regular UI benefit duration	30 weeks
Tax structure	7 tax schedules, triggered by changes in amount of benefit expenditures
Taxable wage base	\$7,000 of each employee's covered wages not indexed

Stable Growth Scenario

The first simulation continues Massachusetts' 1986 economic conditions. Net reserves increase continuously, but at a declining rate and more slowly than covered state payroll growth. Interest on positive trust fund balances totaling \$516 million accounts for all net reserve growth, as benefit expenditures actually exceed annual taxes by \$255 million over the period. Although the model projects an increase in net state trust fund reserves of 20 percent by 1996, the High Cost Multiple falls to 0.52 in 1996—a 20-percent decline from 1986.

Inflation Scenario

The second scenario combines continued low unemployment with strong wage growth. This scenario illustrates the danger inflation poses to a

trust fund like Massachusetts', which has benefits indexed to changes in the state average weekly wage but does not index the taxable wage base or other revenue sources. Although high inflation by itself does not cause trust fund insolvency, it significantly reduces net reserves. Net trust fund reserves peak at \$1,038 million in 1989 and then decline to \$874 million in 1996. By 1996, net trust fund reserves are 12 percent below 1986 levels. UI taxes are paid on only 16 percent of the state's total insured wages, down from 35 percent in 1986, and only two of the seven state UI tax schedules remain available for future revenue increases. Given the decline in reserves, the High Cost Multiple declines to 0.23, nearly a 61-percent decline from 1986.

Moderate Recession

The third simulation reflects the impact of a moderate recession on the state's UI system. Stable wage growth is coupled with an annual unemployment rate equal to 85 percent of the annual national rate during the 1980's (see table II.1). Under these conditions, the fund avoids insolvency but is left in an extremely weakened condition. Massachusetts net trust fund reserves decline to only \$64 million in 1991, before recovering to \$709 million by 1996. The High Cost Multiple declines to 0.03 in 1991, before recovering to 0.29 in 1996.

Severe Recession

The fourth simulation is a "worst case" scenario whereby Massachusetts is assumed to experience a repeat of the state's dismal rates of unemployment and inflation of the 1970's. Net trust fund reserves are quickly exhausted by high unemployment in 1992, falling into debt with balances of -\$708 million, before improving to -\$431 million in 1996.

Weekly Benefit and Tax Data of Individual State UI Programs (Jan. 1987)

Table III.1: Maximum Weekly Benefit Amounts for Total Unemployment by State (Jan. 4, 1987)

State	Minimum amounts	Maximum amounts
Alabama	\$22	\$120
Alaska	38-62	188-260 ^a
Arizona	40	135
Arkansas	44	196
California	30	166
Colorado	25	213
Connecticut	15-22	204-254 ^a
Delaware	20	205
District of Columbia	26	250
Florida	10	175
Georgia	27	145
Hawaii	5	212
Idaho	44	185
Illinois	51	168-219 ^a
Indiana	40	96-161 ^a
Iowa	24-29	162-199 ^a
Kansas	49	197
Kentucky	22	140
Louisiana	10	205
Maine	25-37	152-228 ^a
Maryland	25-29	195
Massachusetts	14-21	220-330 ^a
Michigan	54	197
Minnesota	58	239
Mississippi	30	130
Missouri	22	130
Montana	44	179
Nebraska	12	126
Nevada	16	171
New Hampshire	36	150
New Jersey	45	228
New Mexico	31	158
New York	40	180
North Carolina	16	184
North Dakota	60	197
Ohio	10	147-233 ^a
Oklahoma	16	197
Oregon	50	216
Pennsylvania	35-40	241-249 ^a
Puerto Rico	7	95

(continued)

**Appendix III
Weekly Benefit and Tax Data of Individual
State UI Programs (Jan. 1987)**

State	Minimum amounts	Maximum amounts
Rhode Island	39-44	191-236 ^a
South Carolina	21	125
South Dakota	28	129
Tennessee	30	130
Texas	32	203
Utah	13	197
Vermont	18	154
Virginia	58	167
Virgin Islands	30	138
Washington	53	197
West Virginia	24	225
Wisconsin	37	196
Wyoming	36	198

^aMaximum weekly benefits vary because of dependent allowances.

Table III.2: State UI Programs With Indexed Taxable Wage Bases, Indexed Maximum Weekly Benefit Amounts (Jan. 1987)

Number of states	Number of states	
	With indexed weekly benefit amounts	Without indexed weekly benefit amounts
With indexed taxable wage bases	17 ^a	1 ^b
Without indexed taxable wage bases	20 ^c	15 ^d

^aHawaii, Idaho, Iowa, Minnesota, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, Utah, Virgin Islands, Washington, and Wyoming.

^bAlaska.

^cArkansas, Colorado, Connecticut, Delaware, Illinois, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Ohio, Pennsylvania, Puerto Rico, South Carolina, South Dakota, Texas, Vermont, West Virginia, Wisconsin.

^dAlabama, Arizona, California, District of Columbia, Florida, Georgia, Indiana, Maryland, Mississippi, Missouri, Nebraska, New Hampshire, New York, Tennessee, and Virginia.

Indicators of Fund and Benefit Adequacy

Table IV.1: Definitions of Trust Fund Indicators

Indicator	Definition
Reserve Ratio	Net trust fund reserves as a fraction of total wages in system insured employment. A larger ratio suggests a greater financial ability to meet benefit obligations.
Benefit Cost Ratio	Trust fund benefit expenditures as a percentage of total wages in UI program employment.
High Cost Multiple	Also known as the reserve cost or reserve ratio multiple. This is the reserve ratio expressed as a multiple of the benefit cost ratio. The reserve ratio is based on payrolls for the current 12-month period and is compared to the trust fund's historically highest 12-month benefit cost ratio. The generally accepted High Cost Multiple standard for financial adequacy is 1.5 and above.
Fund Capacity	Annual net trust fund reserves divided by the product of a program's average annual weekly benefit amount and its average annual potential benefit duration.
Person Years to Employment (PYE) Ratio	The fund capacity variable divided by total system insured employment. It measures the percentage of the system insured work force who could receive the average benefit amount for the average level of duration, given the current level of net trust fund reserves. A higher PYE ratio indicates a trust fund's ability to meet the benefit needs of a greater proportion of potential beneficiaries.

**Appendix IV
Indicators of Fund and Benefit Adequacy**

**Table IV.2: Indicators of Trust Fund
Reserve Adequacy, United States
(1954-86)**

Year	PYE ratio	Reserve ratio	High Cost Multiple
1954	0.416	6.00	3.70
1955	0.397	5.56	3.60
1956	0.354	5.21	3.50
1957	0.331	4.99	3.30
1958	0.250	3.99	2.00
1959	0.235	3.57	1.90
1960	0.202	3.29	1.68
1961	0.172	2.80	1.44
1962	0.177	2.84	1.48
1963	0.180	2.88	1.49
1964	0.189	2.96	1.55
1965	0.199	3.17	1.65
1966	0.210	3.40	1.69
1967	0.218	3.54	1.79
1968	0.272	3.54	1.81
1969	0.220	3.46	1.77
1970	0.187	3.11	1.54
1971	0.141	2.41	1.18
1972	0.114	2.06	1.00
1973	0.117	2.13	1.04
1974	0.111	1.88	0.92
1975	0.027	0.53	0.24
1976	0.007	0.14	0.06
1977	0.007	0.13	0.06
1978	0.027	0.55	0.25
1979	0.050	0.91	0.41
1980	0.032	0.64	0.29
1981	0.026	0.51	0.23
1982	-0.011	-0.02	-0.00
1983	-0.023	-0.47	-0.21
1984	0.008	0.16	0.07
1985	0.035	0.68	0.30
1986	0.050	0.98	0.44

**Appendix IV
Indicators of Fund and Benefit Adequacy**

Table IV.3: Ten Largest State Trust Fund Borrowers (1972-86)

State	Amount borrowed in millions (1972-January 1986)	State loans as share of state covered wages (1986)	State loans as percent of national loan total (1972-86)	State share of national covered wages (1986)	Census division
Northeast:					
Connecticut	\$577.8	1.6	2.2	1.9	New England
New Jersey	813.4	1.1	3.1	3.9	Mid Atlantic
Pennsylvania	5,239.9	6.0	19.9	4.6	Mid Atlantic
Midwest:					
Illinois	4,361.1	4.4	16.6	5.2	East North Central
Michigan	4,292.2	5.5	16.3	4.2	East North Central
Minnesota	1,077.1	3.1	4.1	1.9	West North Central
Ohio	3,233.2	3.8	12.3	4.5	East North Central
Wisconsin	940.0	2.7	3.6	1.9	East North Central
Gulf:					
Louisiana	946.5	3.6	3.6	1.4	West South Central
Texas	1,332.3	1.1	5.1	6.6	West South Central
10-State total	\$22,813.5	•	86.7	36.1	
National total	\$26,328.6				

Table IV.4: Period Growth Rates in the Consumer Price Index, Real Weekly Wages, and Real Average Weekly Benefit Amounts (1949-86)

Time period	Percent growth		
	Consumer price index ^a (1982=100)	Real average weekly benefit amounts ^b (1982=100)	Real average weekly wages ^c (1982=100)
1949-59	24.2	29.2	31.9
1960-69	31.1	24.2	15.3
1970-79	112.2	7.3	-7.5
1980-86	33.6	2.8	3.1
1949-72	75.5	55.3	55.5
1972-86	162.1	-7.5	-6.7
1949-86	359.9	43.6	45.1

^aThe Consumer Price Index is for all urban consumers.

^bThe real average weekly benefit amount is the average weekly benefit amount adjusted by the Consumer Price Index.

^cReal average weekly wages are average weekly wages in covered employment adjusted by the Consumer Price Index.

Appendix IV
Indicators of Fund and Benefit Adequacy

Table IV.5: Regional Economic Performance: Average Annual Unemployment Rates and Employment Growth Rates (1970-86)

Census area	Average employment growth rate		Average unemployment rate	
	1970-79	1980-86	1970-79	1980-86
North East	0.9	1.3	7.0	7.3
New England	1.7	1.8	6.9	5.7
Mid Atlantic	0.6	1.2	7.0	7.8
Mid West/North Central	1.9	0.8	5.6	8.9
East North Central	1.5	0.7	6.1	10.0
West North Central	2.7	0.9	4.2	6.6
South	3.7	2.1	5.5	7.6
South Atlantic	3.5	2.7	5.6	7.0
East South Central	3.3	1.1	5.7	10.0
West South Central	4.2	2.0	5.2	7.5
West	4.0	2.3	7.4	7.9
Mountain	5.6	2.6	6.0	7.2
Pacific	3.5	2.2	7.8	8.2
National total	2.5	1.2	6.2	8.0

Table IV.6: Status of Individual State UI Trust Fund Reserve Adequacy (1954-86)

Year	Trust funds with High Cost Multiples of		Insolvent trust funds
	1.5 and higher	1.0 and higher	
1954	49	49	0
1956	48	49	0
1958	44	45	0
1960	37	45	0
1962	28	44	1
1964	32	46	0
1966	38	50	0
1968	38	51	0
1970	34	51	0
1972	21	31	1
1974	15	28	3
1976	2	6	18
1978	2	6	14
1980	2	14	16
1982	1	3	23
1984	1	5	17
1986	2	11	8

Appendix IV
Indicators of Fund and Benefit Adequacy

**Table IV.7: Trust Fund Insolvency by
Census Divisions (1974-86)**

Census region	Insolvent program years as percentage of all census designation program years
New England	51
Mid-Atlantic	59
East North Central	52
West North Central	18
South Atlantic	23
East South Central	13
West South Central	29
Mountain	7
Pacific	9
Puerto Rico/Virgin Islands	62
National average	28

Who Receives Unemployment Insurance Benefits?

Using the March 1980 and March 1986 CPS¹ supplements, we compared the characteristics of UI recipients to those of all unemployed for calendar years 1979 and 1985. Changes over the 6-year interval are detailed in table V.1.

For tables 3.1 and 3.2 in the text, we tested and found statistically significant (0.05 level) differences between all unemployed persons and unemployment insurance recipients for the percentage that was male, white, and aged 25 to 54; the percentage with family income below the poverty level; and the percentage with prior occupations in mining, transport or construction, durable manufacturing, trade and finance, and services. We did not perform significance tests for the observed differences in the other categories.

¹The CPS is a monthly survey conducted by the Bureau of the Census for the Bureau of Labor Statistics. It obtains the information on employment and unemployment that is used to compute the monthly unemployment rate. Each March, the survey is expanded to obtain information on work experience and income from the previous year.

**Appendix V
Who Receives Unemployment
Insurance Benefits?**

**Table V.1: Comparison of 1979 and 1985
CPS Supplement Results**

	All unemployed persons		UI recipients	
	1979	1985	1979	1985
Age—percent between:				
16 and 24 years	39	31	21	13
25 and 54 years	53	61	66	75
55 years and older	8	8	13	12
Percent male	55	56	62	62
Percent blacks and others	18	19	14	14
Education—percent with:				
Less than H.S. degree	35	29	31	25
H.S. degree, no college	41	44	46	50
At least some college	25	27	23	25
Annual family income—percent with earnings of:				
Less than \$10,000	30	26	22	15
\$10,000 to \$19,999	32	25	38	28
\$20,000 to \$39,999	31	31	35	39
\$40,000 or more	7	18	6	18
Percent of workers receiving welfare ^a	20	23	16	18
Percent of workers from goods-producing industries ^b	44	41	59	57
Employed in services ^b Work status (percent): ^c	20	22	16	16
Full time/full year	8	7	17	15
Full time/part year	61	58	70	68
Part time/full year	1	1	2	3
Part time/part year	19	22	10	10
Percent who are nonworkers ^d	11	12	2	5
Percent of workers:				
In poverty ^e	25	33	17	22
Nonpoor	75	67	83	78

^aIncludes Food Stamps, Housing Assistance, Reduced Price Lunch, Aid to Families with Dependent Children, and Medicaid.

^bGoods-producing industries include agriculture, mining, construction, and manufacturing (durable and nondurable). Services include business and repair services, personal and professional services.

^cFull time is over 35 hours per week; full year is over 50 weeks per year. Part time and part year are less.

^dIncludes people who did not work during prior year.

^ePersons in families with income below the poverty level.

Measures of the Percentage of the Unemployed Receiving Unemployment Insurance

Three ratios used to measure the proportion of the unemployed receiving UI benefits are:

1. The IU/TU Ratio—the ratio of the number of the insured unemployed to the total number of civilian unemployed. The insured unemployed (IU) is the number of recipients of regular UI benefits, including recipients on their 1-week waiting period and applicants who are ultimately denied benefits. Because some claimants are denied benefits and others may be on a 1-week waiting period before the initial receipt of benefits common to most state programs, the number of insured unemployed is actually larger than the number of regular UI beneficiaries.
2. The IUR/TUR ratio—the ratio of the insured unemployment rate to the total civilian unemployment rate.¹ The insured unemployment rate is the average weekly number of insured unemployed divided by the average monthly number of taxable and reimbursable program employed.
3. The TB/TU ratio—the ratio of the number of total beneficiaries to the number of total civilian unemployed. This ratio compares the total number of UI benefit claims from all programs, including those receiving extended UI benefits, various temporary supplemental UI programs as well as the regular state UI program, to the total civilian unemployed. This ratio, while providing the broadest index of benefit receipt, exhibits the greatest variation of the three measures, moving from .75 in 1975 to .33 in 1986 (see table VI.1).

¹The insured unemployment rate is the average weekly number of insured unemployed divided by the average monthly number of taxable and reimbursable covered employment.

**Appendix VI
Measures of the Percentage of the
Unemployed Receiving
Unemployment Insurance**

**Table VI.1: Trends in Unemployment
Insurance Beneficiary Ratios (1967-86)**

Year	IUR/TUR ratio	State IU/TU ratio	TB/TU ratio
1967	0.66	0.404	0.43
1968	0.61	0.394	0.42
1969	0.60	0.389	0.41
1970	0.69	0.441	0.48
1971	0.61	0.432	0.52
1972	0.54	0.379	0.45
1973	0.51	0.373	0.41
1974	0.63	0.438	0.50
1975	0.72	0.501	0.75
1976	0.57	0.404	0.67
1977	0.52	0.379	0.56
1978	0.46	0.380	0.43
1979	0.48	0.397	0.42
1980	0.55	0.439	0.50
1981	0.46	0.368	0.41
1982	0.48	0.380	0.45
1983	0.41	0.317	0.44
1984	0.36	0.290	0.34
1985	0.39	0.314	0.34
1986	0.41	0.322	0.33

**Impact of Coverage
Extensions on the
IUR/TUR Ratio**

UI program coverage extensions have contributed to the reduction in the IUR/TUR ratio. The growth in coverage brought many workers into the UI system from sectors that had lower-than-average industry unemployment rates. Their inclusion tended to lower the IUR while leaving the TUR unchanged, thus reducing their ratio.

Extending coverage to workers from industries with low unemployment rates increases the IUR's denominator (the average number of people in UI-covered employment over four quarters) more than the numerator (number of insured unemployed). This drives down the IUR. Since the TUR doesn't change by expanding UI program coverage, the ratio of the two unemployment rates—IUR/TUR—declines.

For example, the 1976 UI coverage extension to many state and local government workers increased the total number of insured unemployed. However, because government workers historically have exhibited a lower-than-average unemployment rate, the number of UI covered employees increased more than the number of insured unemployed,

**Appendix VI
Measures of the Percentage of the
Unemployed Receiving
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driving down the IUR. Since the TUR does not change by expanding UI program coverage, the ratio of the IUR to the TUR declines.

Background Data on Five Case Study Trust Funds (1981-86)

We examined the legislative response of five states—Colorado, Louisiana, Oklahoma, Texas, and Wyoming—that experienced economic difficulties during the mid-1980's through 1986. The following tables provide summary data for each state.

Colorado

Colorado approved UI legislation during the early and mid-1980's that included UI tax increases and benefit-cost reductions. The state chief of UI research did not have estimates of either the benefit cost provisions' dollar savings or the impact on the number of eligible claimants. We were unable to determine the impact of these changes.

Colorado also enacted significant tax increases. The state raised its UI taxable wage base from \$8,000 to \$9,000 per each employee's wages in calendar year 1987, and it will be fixed at \$10,000 per employee wages in calendar year 1988 if the trust fund reserve does not hit \$350 million. The state chief of UI research forecasts predicted that the taxable wage base will reach the \$10,000 mark. Other revenue changes included levying a nonexperience-rated tax on all new employers and increasing the trigger for the most "favorable" (lowest) experience-rated UI tax schedule.

For fiscal year 1987, the state estimates that increasing the taxable wage base to \$9,000 alone will generate about a 10-percent revenue increase over prior law, not including any interest earned. In fiscal year 1988, with the \$10,000 wage base provision, the legislation is projected to generate over 25 percent in additional revenue over prior law. However, the Colorado UI service forecasted that a recession in 1987 would push the fund into insolvency in 1988.

Appendix VII
Background Data on Five Case Study Trust
Funds (1981-86)

Table VII.1: Financial Status of Colorado
State UI Program (1981-86)

Year	Unemployment rate			Net reserves (thousands)	Reserve ratio	High Cost Multiple
	Insured rate	Total civilian rate	IU/TU ^a			
1981	2.0	5.5	.289	\$94,318	0.57	0.45
1982	2.9	7.7	.299	-3,853	. ^b	. ^b
1983	3.1	6.6	.349	-112,884	. ^b	. ^b
1984	2.2	5.6	.294	-13,531	. ^b	. ^b
1985	2.3	5.9	.303	84,470	0.38	0.30
1986	2.5	7.4	.261	83,120	0.36	0.28
Period averages	2.5	6.5	.30			

^aThe number of insured unemployed workers divided by the number of total unemployed workers.

^bNegative value.

Table VII.2: Colorado Legislative
Summary (1981-86)

Category	Description
Tax changes	Indexed taxable wage base.
	Levied flat payroll tax on new employers.
	Increased the trigger level for most favorable (lowest) tax rate schedule.
Benefit changes	Tightened monetary eligibility standards.
	Created new disqualifications.
	Reduced penalties for certain disqualifications.
	Subtracted severance pay from UI benefit duration.
	Expanded coverage exclusions.
	Modified weekly benefit computation formula.
	Modified maximum weekly benefit amount index formula.

Louisiana

Louisiana approved major UI legislation during the early 1980's. The legislature approved large UI tax increases phased in over several years and also modified affecting program benefit provisions that reduced the proportion of the unemployed receiving benefits. State UI tax modifications included a surtax for certain employers, a temporary 4-year solvency surtax to repay federal loan principal, another surtax to pay for prior years' federal loan interest, and an explicit tax to cover benefits not charged to any particular employer.

Despite the benefit changes and major tax increases during ensuing years, Louisiana's trust fund difficulties have remained. In 1986, the governor formed a tripartite UI task force, consisting of business, labor,

**Appendix VII
Background Data on Five Case Study Trust
Funds (1981-86)**

and public representatives, to deal with trust fund difficulties and the state's general economic crisis. The task force report, to be released in 1988, is to recommend that the state float a \$1.2 billion bond issue to pay off federal loan principal and interest and to maintain a \$250 million trust fund reserve by issuing state bonds. To finance the bonds, Louisiana approved a flat rate payroll tax increase on employers and raised the taxable wage base for the state UI taxes to \$8,500 as of January 1988. In the event of future trust fund difficulties, employee benefits may be reduced by 7 percent and the state can levy an additional payroll surtax.

**Table VII.3: Financial Status of Louisiana
State UI Program (1981-86)**

Year	Unemployment rate			Net reserves (thousands)	Reserve ratio	High Cost Multiple
	Insured rate	Total civilian rate	IU/TU ^a			
1981	2.6	8.4	.260	\$210,409	0.99	0.51
1982	4.5	10.3	.361	-102,343	. ^b	. ^b
1983	5.4	11.8	.358	-520,365	. ^b	. ^b
1984	3.8	10.0	.300	-521,188	. ^b	. ^b
1985	4.4	11.5	.290	-576,948	. ^b	. ^b
1986	5.6	13.1	.311	-786,692	. ^b	. ^b
Period averages	4.4	10.9	.31			

^aThe number of insured unemployed workers divided by the number of total unemployed workers.

^bNegative value.

Appendix VII
 Background Data on Five Case Study Trust
 Funds (1981-86)

**Table VII.4: Louisiana Legislative
 Summary (1981-86)**

Category	Description
Tax changes	Approved large, phased-in experience-rated tax rate increase, especially for negative balance employers, rather than smaller but immediate increase as required by existing law.
	Levied additional 5-percent surtax on all negative balance employers.
	Levied solvency surtax to repay federal loans.
	Levied special "noncharged benefits" tax.
	Levied flat rate interest surtax to pay prior year interest on federal loans.
	Increased state power to collect tax delinquencies.
Benefit changes	Tightened benefit amount and benefit duration formulas.
	Reduced maximum program benefit duration.
	Tightened monetary eligibility standards.
	Imposed income disqualification for severance pay.
	Froze maximum weekly benefit amount.
	Eliminated 1-week benefit waiting period waiver.
	Reduced state share of extended benefits to match federal Gramm-Rudman reduction.

Oklahoma

Oklahoma approved legislation modifying both UI taxes and benefits during the 1980's. Many of the benefit changes reduced the proportion of the unemployed receiving benefits. The state also enacted significant increases in UI taxes. The state experience-rated UI tax schedule was broadened, with maximum tax rates increased significantly. These changes steadily increased the average UI tax rate on the state's 66,000 employers from 0.4 percent in 1982 to 1.1 percent in 1986. Beginning in 1986, the state taxable wage base was also indexed to 50 percent of the state's average weekly wage from the preceding calendar year. The state UI taxable wage base increased from \$7,000 to \$8,900 in 1986 and \$9,100 in 1987.

However, the assistant research director of the State Employment Security Commission estimated that, despite these changes, trust fund solvency will not improve much if unemployment remains at current levels, and any unemployment increase will push the trust fund toward insolvency.

Appendix VII
Background Data on Five Case Study Trust
Funds (1981-86)

Table VII.5: Financial Status of Oklahoma
State UI Program (1981-86)

Year	Unemployment rate		IU/TU ^a	Net reserves (thousands)	Reserve ratio	High Cost Multiple
	Insured rate	Total civilian rate				
1981	1.3	3.6	.285	\$212,732	1.37	1.02
1982	2.9	5.7	.394	108,387	0.64	0.48
1983	3.1	9.0	.243	30,486	0.20	0.15
1984	2.0	7.0	.202	82,835	0.50	0.37
1985	2.4	7.1	.238	105,720	0.65	0.47
1986	3.4	8.2	.272	65,583	0.42	0.31
Period averages	2.5	6.8	0.27			

^aThe number of insured unemployed workers divided by the number of total unemployed workers

Table VII.6: Oklahoma Legislative
Summary (1981-86)

Category	Description
Tax changes	Increased and widened tax rate schedule. Indexed taxable weekly wage.
Benefit changes	Tightened monetary qualifications. Tightened benefit duration formula. Reduced and then froze maximum weekly benefit amount. Tightened weekly benefit amount computation formula. Extended benefits to be reduced to match federal Gramm-Rudman reduction.

Texas

During the early 1980's, Texas repeatedly pursued significant UI legislative action addressing trust fund solvency. Although the state did take some actions that reduced the proportion of the unemployed receiving benefits, most changes affected UI taxes.

In the past, the Texas UI program had been characterized by low employer UI tax rates and trust fund reserves coupled with tax schedule triggers that were very responsive to changes in reserve levels. The 1982 recession eliminated Texas UI trust fund reserves, quickly triggering large employer tax increases. To phase in the triggered employer tax increase, a special legislative session in 1982 reduced the responsiveness of the trigger mechanism while increasing maximum UI tax rates. Additional legislation in 1983 and 1985 further slowed the rate of tax increase by modifying the trust fund trigger mechanism. The legislature also approved additional surtaxes to pay for trust fund loan interest.

Appendix VII
Background Data on Five Case Study Trust
Funds (1981-86)

Despite modest improvement in 1985, the state trust fund became insolvent again in 1986 and remains so in 1988.

Table VII.7: Financial Status of Texas
State UI Program (1981-86)

Year	Unemployment rate			Net reserves (thousands)	Reserve ratio	High Cost Multiple
	Insured rate	Total civilian rate	IU/TU ^a			
1981	1.1	5.3	0.173	\$253,841	0.30	0.31
1982	2.0	6.9	0.241	-142,462	. ^b	. ^b
1983	2.4	8.0	0.237	-696,274	. ^b	. ^b
1984	1.5	5.9	0.197	-416,289	. ^b	. ^b
1985	1.5	7.0	0.167	2,995	. ^b	. ^b
1986	2.6	8.9	0.170	-365,640	. ^b	. ^b
Period averages	1.9	7.0	0.20			

^aThe number of insured unemployed workers divided by the number of total unemployed workers.

^bNegative value.

Table VII.8: Texas Legislative Summary
(1981-86)

Category	Description
Tax changes	Increased maximum tax rates, with an additional tax rate schedule for highly experience-rated employers.
	Increased ceiling fund requirements for the most favorable tax schedule, then indexed them to 2 percent of the total state taxable wages.
	Increased floor fund requirements for least favorable tax schedule, then indexed them to 1 percent of total state taxable wages.
	Reduced the tax trigger mechanism, later modified it to a more flexible experience-rated schedule ranging up to 2 percent of taxable payroll.
Benefit changes	Increased misconduct, suitable work, and voluntary leaving disqualification penalties.
	Established a variable 6- to 26-week disqualification for individuals who voluntarily left to move with a spouse from the area where they worked.

Wyoming

Wyoming changed its state UI law during the 1980's, modifying both taxes and benefits. The provisions reducing the proportion of the unemployed receiving benefits included increasing disqualification penalties and increasing monetary eligibility requirements. On the revenue side, the state indexed its UI tax base. Despite these changes, the director of the Wyoming Job Service Commission still forecasted major problems for its trust fund during 1988.

**Appendix VII
Background Data on Five Case Study Trust
Funds (1981-86)**

**Table VII.9: Financial Status of Wyoming
State UI Program (1981-86)**

Year	Unemployment rate			Net reserves (thousands)	Reserve ratio	High Cost Multiple
	Insured rate	Total civilian rate	IU/TU ^a			
1981	1.7	4.1	0.347	\$72,452	2.39	0.98
1982	3.7	5.8	0.499	46,006	1.51	0.62
1983	5.0	8.4	0.428	6,560	0.25	0.08
1984	2.4	6.3	0.282	27,277	1.01	0.33
1985	2.4	7.1	0.258	45,250	1.60	0.53
1986	4.1	9.0	0.343	37,383	1.44	0.47
Period averages	2.9	6.8	0.360			

^aThe number of insured unemployed workers divided by the number of total unemployed workers.

**Table VII.10: Wyoming Legislative
Summary (1981-86)**

Category	Description
Tax changes	Indexed taxable wage base.
	Made annual graduated increases in UI base tax rates to 8.5 percent in 1987 and thereafter.
Benefit changes	Adjusted ceiling and floor triggers for alternative tax schedules to percentage of total state payrolls.
	Increased penalty for misconduct disqualification.
	Increased monetary standards for benefit eligibility.
	Imposed benefit disqualification for severance pay termination allowance recipients.
	Reduced state share of extended benefits to equal federal Gramm-Rudman reduction.
	Expanded pension offset to all pension income except certain service-related disability pensions.
	Empowered governor to reduce weekly benefit amounts depending on level of state trust fund solvency.

Summary of Major UI Legislation (1935-87)

Table VIII.1: Summary of Major Federal UI Legislation (1935-87)

Legislation	Description
P.L. 73-30 (June 1933)	The Wagner-Peyser Act established the U.S. Employment Service, the national system of public employment offices, within the Department of Labor.
P.L. 74-271 (Aug. 1935)	The Social Security Act established the framework of the federal-state UI system. Key provisions include the credit device for taxes paid under state UI laws that meet federal standards, federal financing of administrative state costs, and substantial state autonomy over state UI programs.
P.L. 75-722 (June 1938)	Established a separate federal UI system for the railroad industry.
P.L. 76-379 (Aug. 1939)	Limited the federal UI tax base to employees' first \$3,000 of earnings; enacted minor coverage changes.
P.L. 79-719 (Aug. 1946)	Extended program coverage to maritime service.
P.L. 83-567 (Aug. 1954)	The Reed Act earmarked all federal UI tax monies for UI purposes; created loan fund to help states meet benefit obligations; allowed certain surplus loan fund monies to be used by states to pay for benefits, UI office construction, and other uses.
P.L. 83-767 (Sept. 1954)	Extended program coverage to federal employees.
P.L. 85-441 (June 1958)	Established first temporary extended benefits program.
P.L. 85-848 (Oct. 1958)	Permanently extended UI program coverage to unemployed war veterans.
P.L. 86-778 (Sept. 1960)	Restructured federal loan requirements to state trust funds unable to meet their benefit payments in the current or following month.
P.L. 91-373 (Aug. 1970)	Made major structural changes, including a permanent, 13-week federal-state shared cost extended benefits program; coverage extensions to employees in state hospitals, higher education institutions, most nonprofit organizations, and small employers; a provision to allow certain employers to pay UI benefits on a reimbursable basis; a taxable wage base increase to \$4,200 per worker; and several new federal standards regarding benefit rights and interstate claims.
P.L. 93-567 (Dec. 1974)	Provided 26 additional weeks of fully federally financed UI benefits—Special Unemployment Assistance.
P.L. 93-572 (Dec. 1974)	Established fully federally financed temporary 13-week Federal Supplemental Benefits program.
P.L. 93-618 (Jan. 1975)	Established Trade Adjustment Assistance Program.
P.L. 94-566 (Oct. 1976)	Made major coverage expansions to state and local government employees, nonprofit elementary and secondary school employees, certain house workers, and many farmworkers; increased federal UI tax and taxable wage base to \$6,000 per worker; made other changes.
P.L. 95-600 (Nov. 1978)	Imposed the partial federal income taxation of UI benefits.
P.L. 96-499 (Dec. 1980)	Amended and added federal standards regarding the permanent extended benefits program; made other changes

(continued)

Appendix VIII
Summary of Major UI Legislation (1935-87)

Legislation	Description
P.L. 97-35 (Aug. 1981)	Amended permanent extended benefits program trigger; child support intercept amendments; revised federal loan provisions to charge interest on loans to borrowing state trust funds; and made changes in trade readjustment assistance program and veterans' benefits.
P.L. 97-248 (Sept. 1982)	Established temporary Federal Supplemental Compensation (FSC) program providing additional weeks of UI benefits; made minor coverage changes; increased federal taxable wage base to \$7,000; increased the maximum federal UI tax rate; expanded the federal taxation of UI benefits; made other changes.
P.L. 98-21 (Apr. 1983)	Extended and modified FSC program; provided financial incentives to state programs, which improved trust fund solvency; made other changes.
P.L. 99-514 (Oct. 1986)	Imposed the full federal income taxation of UI benefits.
P.L. 100-203 (Dec. 1987)	Extended temporary 0.2-percent Federal Unemployment Tax for 3 years; funded several state UI demonstration projects.

Summary of Standards for Maintenance of Federally Approved State UI Program

The number of standards as a condition for state programs to receive federal approval has grown over the last 40 years, especially during the 1970's and 1980's. The following is a current list and description of federal standards for state UI program approval.

Section 3304 of the Internal Revenue Code of 1954 provides that the Secretary of Labor shall approve a state UI law giving employers covered under that state law a 5.4-percent credit against the 6.2 percent federal tax, if under the state law:

1. Compensation (benefits) is paid through public employment offices or other approved agencies.
2. All the funds collected under the state program are deposited in the Federal Unemployment Trust Fund (title IX of the Social Security Act prescribes the distribution of the tax among various trust fund accounts).
3. All of the money withdrawn from the unemployment fund is used to pay unemployment compensation or to refund amounts erroneously paid to the fund.
4. Compensation is not denied to anyone who refuses to accept work because the job is vacant as a direct result of a labor dispute or because

the wages, hours, or conditions of work are substandard or if, as a condition of employment, the individual would have to join a company union or resign or refrain from joining any bona fide labor organization.

5. Compensation is paid to employees of state and local governments (with required limitations on benefit entitlement during vacation periods for employees in education).
6. Compensation is paid to employees of FUTA tax-exempt nonprofit organizations, including schools and colleges, that employ four or more workers in each of 20 weeks of the calendar year.
7. Compensation is not payable in 2 successive benefit years to an individual who has not worked in covered employment after the beginning of the first benefit year.
8. Compensation is not denied to anyone solely because he is taking part in an approved training program.
9. Compensation is not denied or reduced because an individual's claim for benefits was filed in another state or Canada.
10. The only reasons for cancellation of wage credits or total benefit rights are discharge for work-connected misconduct, fraud, or receipt of disqualifying income.
11. Extended compensation is payable under the provisions of the Extended Unemployment Compensation Act of 1970.
12. The state participates in arrangements for combining wages earned in more than one state for eligibility and benefit purposes.
13. Reduced rates are permitted employers only on the basis of their experience with respect to unemployment.
14. State and local governments may choose between paying regular employer contributions or financing benefit costs by the reimbursement method.
15. No individual shall be denied compensation solely on the basis of pregnancy or termination of pregnancy.

16. Compensation may not be payable to a professional athlete between seasons who is under contract to resume employment when the new season begins.

17. Compensation may not be payable to an alien not legally available to work in the United States.

18. The benefit amount of an individual shall be reduced by that portion of a pension or other retirement income that is funded by a base period employer (including 50 percent of primary social security or railroad retirement payment).

19. Wage information in the agency files must be made available, upon request and on a reimbursable basis, to the agency administering Aid to Families With Dependent Children.

20. The following specific provisions of the Federal-State Extended Unemployment Compensation Act of 1970 must be adopted by state law:

- Specific requirements for defining suitable work and imposing disqualifications thereto.
- Extended benefit payments limited to 2 weeks if a claimant moves from a state that triggered the extended benefits program to a state that is not paying extended benefits.
- No provision of state law that terminated a disqualification for voluntary quit, discharge for misconduct, or job refusal, other than by new employment, shall apply for purposes of determining eligibility for extended benefits.
- No individual may be eligible for extended benefits unless during his base period for regular UI he had 20 weeks of full-time insured employment or the equivalent in insured wages (40 times the individual's most recent weekly benefit or 1.5 times earnings in the highest quarter in the base period).

21. Any interest required to be paid in advance shall be paid in a timely manner and shall not be paid directly or indirectly (by an equivalent tax reduction in such state) from amounts in such state's unemployment fund.

Title III of the Social Security Act provides for payments from the Federal Unemployment Fund to the states to meet the necessary costs of administering the unemployment compensation programs in the states

and the major proportion of their costs (97 percent) of their public employment offices. Under this title, the grants are restricted to the states that have been certified by the Secretary of Labor as providing:

1. Methods of administration (including a state merit system) that will ensure full payment of unemployment compensation when due.
2. Unemployment compensation payment through public employment agencies or other approved agencies.
3. For fair hearings to individuals whose claims for unemployment compensation have been denied.
4. For the payment of all funds collected to the federal unemployment trust fund.
5. That all of the money withdrawn from the fund will be used either to pay unemployment compensation benefits, exclusive of administration expenses, or to refund amounts erroneously paid into the fund; except that if the state law provides for the collecting of employee payments, amounts equal to such collections may be used to provide disability payments.
6. For making the reports required by the Secretary of Labor.
7. For providing information to federal agencies administering public works programs or assistance through public employment.
8. For limiting expenditures to the purpose and amounts found necessary by the Secretary of Labor.
9. For repayment of any funds the Secretary of Labor determines were not spent for unemployment compensation purposes or exceeded the amount necessary for proper administration of the state unemployment compensation law.
10. For providing information to the Department of Agriculture and state food stamp agencies with respect to wages, benefits, home addresses, and job offers.
11. For providing wage information to any state or local child support agency.

12. For requiring that all claimants disclose whether they owe child support obligations. Deductions from benefits shall be made for any such child support obligations, and the amount of such deduction paid by the state agency to the appropriate child support agency.

13. The Secretary shall make no certification for payment to any state if he finds that any interest on advances has not been paid by the date on which it is required to be paid or has been paid directly or indirectly (by an equivalent reduction in state unemployment taxes or otherwise) by such states from amounts in the state's unemployment fund, until such interest is properly paid.

14. The state agency charged with administration of the UI law must provide that information shall be requested and exchanged for purposes of income and eligibility verification in accordance with a state system meeting the requirements of title XI of the Social Security Act. The UI wage record system may, but need not, be the required state system.

Data for Text Figures

Table IX.1: Data for Figure 1

Years	Trust funds with adequate financial reserves ^a	Insolvent trust funds ^b
1969	39	0
1970	34	0
1971	22	0
1972	21	1
1973	21	1
1974	15	3
1975	2	13
1976	2	18
1977	1	20
1978	2	14
1979	2	10
1980	2	16
1981	1	16
1982	1	23
1983	0	23
1984	1	17
1985	1	8
1986	2	8

^aTrust funds with adequate financial reserves are defined as those with a High Cost Multiple of 1.5 or greater

^bInsolvent trust funds are defined as those having a negative net balance at the end of a calendar year.

**Appendix IX
Data for Text Figures**

Table IX.2: Data for Figure 1.2

Figures in percent

Year	Employed wage and salary workers^a	Total employed civilians
1950	73.51	55.82
1953	73.80	59.93
1956	75.31	61.10
1959	72.51	61.19
1962	71.89	61.90
1965	72.44	63.44
1968	74.27	66.33
1971	74.64	66.83
1974	86.19	77.13
1977	86.32	77.05
1980	98.67	87.53
1983	95.37	86.15
1986	97.63	87.57

^aEmployed wage and salary workers include only nonagricultural employees before 1957. Program coverage was extended to many agricultural workers in 1976.

Appendix IX
Data for Text Figures

Table IX.3: Data for Figure 2.1

Dollars in billions		
Year	Revenues^a	Expenditures^b
1969	\$3.081	\$2.126
1970	3.114	3.847
1971	4.150	6.268
1972	4.377	4.761
1973	5.599	4.162
1974	5.981	6.373
1975	5.829	13.233
1976	8.090	10.444
1977	9.720	9.533
1978	11.845	8.341
1979	13.177	9.360
1980	12.774	15.048
1981	13.330	14.564
1982	13.789	22.389
1983	15.987	19.419
1984	20.318	13.253
1985	21.209	14.730
1986	20.318	16.028

^aRevenues include all state UI taxes, interest on trust fund balances, and reimbursable benefit payments.

^bExpenditures include regular state UI benefits, state share of UI benefits, and reimbursable benefit payments.

**Appendix IX
Data for Text Figures**

Table IX.4: Data for Figure 2.2

Dollars in billions	
Years	Net reserves
1969	\$12.64
1970	11.90
1971	9.73
1972	9.40
1973	10.52
1974	10.51
1975	3.07
1976	0.87
1977	0.95
1978	4.55
1979	8.63
1980	6.59
1981	5.75
1982	-2.64
1983	-5.80
1984	2.22
1985	10.07
1986	15.40

Table IX.5: Data for Figure 2.3

Years	High Cost Multiple
1969	1.77
1970	1.54
1971	1.18
1972	1.00
1973	1.04
1974	.92
1975	.24
1976	.06
1977	.06
1978	.25
1979	.41
1980	.29
1981	.23
1982	- .009
1983	- .21
1984	.07
1985	.30
1986	.44

Appendix IX
Data for Text Figures

Table IX.6: Data for Figure 2.4

Ratio value	1954-69	1970-79	1980-86
High Cost Multiple	2.11	64	.16
Reserve ratio	3.80	1.31	.31
PYE ratio ^a	2.51	79	17

^aPYE ratio divided by 10.

**Appendix IX
Data for Text Figures**

Table IX.7: Data for Figure 2.5

Years	Trust funds	
	Financially adequate ^a	Insolvent ^b
1954	49	0
1955	49	0
1956	48	0
1957	47	0
1958	44	0
1959	40	1
1960	37	0
1961	29	1
1962	28	1
1963	28	1
1964	32	0
1965	33	0
1966	38	0
1967	40	0
1968	38	0
1969	39	0
1970	34	0
1971	22	0
1972	21	1
1973	21	1
1974	15	3
1975	2	13
1976	2	18
1977	1	20
1978	2	14
1979	2	10
1980	2	16
1981	1	16
1982	1	23
1983	0	23
1984	1	17
1985	1	8
1986	2	8

^aFinancially adequate trust funds are all funds with High Cost Multiple ratios of 1.5 and above.

^bInsolvent trust funds are all funds that have negative net balances at the end of a calendar year.

Appendix IX
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Table IX.8: Data for Figure 2.6

Years of insolvency	Number of states
0	22
1-3	8
4-6	9
7-9	6
5-10 or more	8

Table IX.9: Data for Figure 2.7

Census division	Percent
New England	66
Middle Atlantic	61
East North Central	30
West North Central	10
South Atlantic	20
East South Central	13
West South Central	8
Mountain	4
Pacific	20
Puerto Rico/Virgin Islands	58
National total	25

Table IX.10: Data for Figure 2.8

Census division	Percent
New England	38
Middle Atlantic	57
East North Central	71
West North Central	24
South Atlantic	25
East South Central	14
West South Central	46
Mountain	9
Pacific	0
Puerto Rico/Virgin Islands	64
National total	30

Appendix IX
Data for Text Figures

Table IX.11: Data for Figure 2.9

Dollars in billions		
Years	High Cost Multiple	Net reserves
1986	.37	\$15.56
1987	.44	19.64
1988	.49	23.19
1989	.49	25.03
1990	.46	25.22
1991	.44	25.20
1992	.39	24.06

Table IX.12: Data for Figure 2.10

Dollars in millions		
Years	Reserves	
	Stable growth	Inflation
1986	\$990	\$990
1987	1,005	1,038
1988	1,015	1,038
1989	1,024	1,005
1990	1,029	994
1991	1,072	1,008
1992	1,111	995
1993	1,142	998
1994	1,164	965
1995	1,179	941
1996	1,186	874

**Appendix IX
Data for Text Figures**

Table IX.13: Data for Figure 2.11

Dollars in millions		
Years	Reserves	
	Moderate recession	Severe recession
1986	\$990	\$990
1987	942	935
1988	707	599
1989	554	525
1990	173	438
1991	64	313
1992	302	-708
1993	433	-836
1994	480	-814
1995	589	-551
1996	709	-438

Table IX.14: Data for Figure 2.12

	1949-59	1960-69	1970-79	1980-86
Real economic growth rate ^a	3.4	4.6	3.3	2.2
Total civilian unemployment rate	4.6	4.8	6.2	8.0
Adult male unemployment rate ^b	3.6	3.1	3.6	5.9
Rate of price inflation ^c	2.4	2.2	6.3	5.0

^aThe real economic growth rate is the annual increase in the Gross National Product adjusted for inflation.

^bThe adult male unemployment rate is for all males age 25 and over.

^cThe rate of price inflation is measured by the average changes in the Consumer Price Index for all Urban Consumers (1967 = 100).

**Appendix IX
Data for Text Figures**

Table IX.15: Data for Figure 2.13

Years	Real average weekly wages (1982 dollars)^a	Nominal average weekly wages (current dollars)
1969	353.63	134.31
1970	350.72	141.09
1971	355.02	148.96
1972	358.46	155.36
1973	355.59	163.71
1974	345.02	176.27
1975	341.25	190.28
1976	345.70	203.88
1977	346.65	217.63
1978	344.58	232.90
1979	336.20	252.82
1980	324.35	276.89
1981	320.63	301.89
1982	321.95	321.95
1983	325.11	335.57
1984	325.29	350.04
1985	327.84	365.38
1986	334.53	380.00

^aReal average weekly wages in 1982 dollars are adjusted for inflation using the Consumer Price Index for Urban Consumers (1982 = 100).

**Appendix IX
Data for Text Figures**

Table IX.16: Data for Figure 2.14

Year	Real average weekly benefits (1982 dollars)^a	Nominal average weekly benefits (current dollars)
1969	121.56	46.17
1970	125.06	50.31
1971	129.54	54.35
1972	128.79	55.82
1973	128.15	59.00
1974	125.76	64.25
1975	125.95	70.23
1976	127.44	75.16
1977	125.37	78.71
1978	123.79	83.67
1979	119.26	89.68
1980	115.91	98.95
1981	113.23	106.61
1982	119.34	119.34
1983	119.74	123.59
1984	114.74	123.47
1985	114.91	128.06
1986	119.13	135.32

^aReal average weekly benefit amounts in 1982 dollars are adjusted for inflation using the Consumer Price Index for Urban Consumers (1982 = 100)

Appendix IX
Data for Text Figures

Table IX.17: Data for Figure 2.15

Year	Nominal taxable wage base, per worker (current dollars)	Real taxable wage base, per worker (1967 dollars) ^a
1950	3,000	4.161
1953	3,000	3.745
1956	3,000	3.686
1959	3,000	3.436
1962	3,000	3.311
1965	3,000	3.175
1968	3,000	2.879
1971	3,000	2.473
1974	4,200	2,844
1977	4,200	2,314
1980	6,000	2,431
1983	7,000	2,346
1986	7,000	2.132

^aThe real taxable wage base in 1967 dollars is adjusted for inflation using the Consumer Price Index for Urban Consumers (1967 = 100)

Table IX.18: Data for Figure 2.16

Year	Ratio (percent)
1950	79.1
1953	71.6
1956	66.8
1959	61.7
1962	59.1
1965	55.9
1968	51.7
1971	45.3
1974	47.5
1977	45.1
1980	44.7
1983	43.1
1986	40.7

Appendix IX
Data for Text Figures

Table IX.19: Data for Figure 3.1

Year	Total civilian unemployment rate ^a
1950	5.3
1951	3.3
1952	3.0
1953	2.9
1954	5.5
1955	4.4
1956	4.1
1957	4.3
1958	6.8
1959	5.5
1960	5.5
1961	6.7
1962	5.5
1963	5.7
1964	5.2
1965	4.5
1966	3.8
1967	3.8
1968	3.6
1969	3.5
1970	4.9
1971	5.9
1972	5.6
1973	4.9
1974	5.6
1975	8.5
1976	7.7
1977	7.1
1978	6.1
1979	5.8
1980	7.1
1981	7.6
1982	9.7
1983	9.6
1984	7.5
1985	7.2
1986	7.0

^aThe total number of unemployed divided by the total civilian labor force 16 years of age and over, as reported by the Bureau of Labor Statistics.

Appendix IX
Data for Text Figures

Table IX.20: Data for Figure 3.2

Year	IU/TU ratio ^a
1950	.457
1951	.472
1952	.544
1953	.542
1954	.528
1955	.440
1956	.441
1957	.506
1958	.546
1959	.445
1960	.494
1961	.485
1962	.455
1963	.440
1964	.423
1965	.394
1966	.369
1967	.404
1968	.394
1969	.389
1970	.441
1971	.432
1972	.379
1973	.373
1974	.438
1975	.501
1976	.404
1977	.379
1978	.380
1979	.397
1980	.439
1981	.368
1982	.380
1983	.317
1984	.290
1985	.314
1986	.322

^aThe ratio of the number of UI insured unemployed to the number of total civilian unemployed.

**Appendix IX
Data for Text Figures**

Table IX.21: Data for Figure 3.3

Year	IU/TU ratio^a
1950-59	.492
1960-69	.425
1970-79	.412
1980-86	.347

^aThe ratio of the number of UI insured unemployed to the number of total civilian unemployed.

Table IX.22: Data for Figure 3.4

Year	Percent of total civilian unemployed
1970	71.66
1971	70.97
1972	72.94
1973	74.91
1974	74.61
1975	69.78
1976	71.01
1977	72.59
1978	74.85
1979	74.52
1980	70.17
1981	70.13
1982	65.52
1983	63.72
1984	65.92
1985	66.66
1986	63.92

Appendix IX
Data for Text Figures

Table IX.23: Data for Figure 3.5

Year	Long-term unemployment rate ^a
1969	0.16
1970	0.28
1971	0.61
1972	0.65
1973	0.39
1974	0.41
1975	1.29
1976	1.40
1977	1.04
1978	0.64
1979	0.50
1980	0.76
1981	1.06
1982	1.61
1983	2.29
1984	1.43
1985	1.11
1986	1.01

^aThe number of people unemployed for 27 weeks or more, divided by the total civilian labor force.

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Data for Text Figures**

Table IX.24: Data for Figure 3.6

Year	Percent of exhaustees
1969	19.8
1970	24.4
1971	30.5
1972	28.9
1973	27.6
1974	31.2
1975	37.8
1976	37.8
1977	33.4
1978	26.8
1979	26.7
1980	33.2
1981	32.4
1982	38.5
1983	38.4
1984	33.8
1985	31.3
1986	32.5

Note: Claimants are defined as the number of first time payments made during the benefit year, excluding all extended benefit and temporary programs' payments.

Appendix IX
Data for Text Figures

Table IX.25: Data for Figure 3.7

Year	Percent of total civilians who are employed part time ^a
1970	16.85
1971	17.27
1972	17.22
1973	17.01
1974	17.47
1975	18.70
1976	18.35
1977	18.27
1978	17.98
1979	17.85
1980	18.73
1981	18.96
1982	20.51
1983	20.27
1984	19.21
1985	19.00
1986	18.99

^aPart-time employment is employment for less than 35 hours a week for any reason.

Table IX.26: Data for Figure 4.1

Dollars in billions		
Fiscal year ^a	Outstanding FUA loans	Net balance ^b
1973	\$.094	\$.511
1974	.109	.529
1975	.659	.009
1976	3.096	-2.428
1977	4.488	-3.819
1978	5.342	-4.684
1979	5.073	-4.415
1980	4.567	-3.909
1981	6.164	-5.506
1982	8.588	-7.931
1983	13.203	-12.993
1984	9.782	-9.124
1985	6.311	-5.642
1986	4.766	-4.108

^aDefinition of fiscal year modified in 1976.

^bNet balance is defined as all trust fund loan repayments minus all general revenue transfers.

**Appendix IX
Data for Text Figures**

Table IX.27: Data for Figure 4.2

Dollars in millions		
Year	Employer penalty taxes	FUA interest charges
1973	\$0	\$0
1974	0	0
1975	12.5	0
1976	4	0
1977	13.7	0
1978	3	0
1979	4.3	0
1980	59.4	0
1981	322.9	0
1982	461.2	1.1
1983	624.2	140.1
1984	879.9	320.5
1985	1,101.7	261.1
1986	947.5	354.6

Table IX.28: Data for Figure 4.3

Dollars in millions	
Year	Voluntary loan repayments^a
1973	\$0
1974	0
1975	0
1976	10.0
1977	109.4
1978	83.1
1979	311.2
1980	1,264.7
1981	245.8
1982	362.4
1983	2,561.0
1984	5,800.3
1985	5,129.6
1986	2,827.0

^aDoes not include employer penalty taxes.

Comments From the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employment and Training
Washington, D.C. 20210



JUL 1 1988

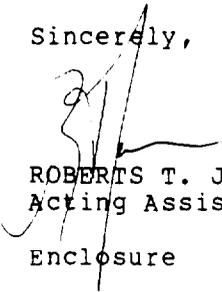
Mr. Lawrence H. Thompson
Assistant Comptroller General
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Thompson:

In reply to your letter to Secretary McLaughlin requesting comments on the draft GAO report entitled "UNEMPLOYMENT INSURANCE Trust Fund Reserves Inadequate," the Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,


ROBERTS T. JONES
Acting Assistant Secretary of Labor

Enclosure

U.S. Department of Labor's Response To
The Draft General Accounting Office Report
Entitled --

UNEMPLOYMENT INSURANCE
Trust Fund Reserves Inadequate

The Department of Labor (DOL) has reviewed the subject report and has specific comments on statements, data, etc., which are listed by page number. In general, the Department has two comments concerning the report that it feels are significant. The first concerns the adequacy of trust funds. The Department appreciates the very real possibility that a deep recession could lead to significant borrowing by States. However, the availability of loans has been a part of the design of the UI system for three decades and borrowing does not represent an inherent flaw. The tax structures which States utilize to fund the benefits authorized under their individual statutes have traditionally been a matter of State discretion. The Department has worked closely with States on solvency issues; setting guidelines, developing benefit models, and providing technical assistance. Over the years, State tax structures have evolved which tend to provide replenishment of State trust funds at the high points in the business cycle. This general system is working now for most former borrowing States as their economies recover from the recessions of the early 80's. Law changes which provided incentives for prompt loan payback also promote solvency. The result is that the solvency situation is brighter today than when the GAO gathered information for its report. The Department does not believe a solvency standard is feasible or is needed. The Department will discuss this further at the hearing scheduled by the House Employment and Housing Subcommittee of the Committee on Government Operations.

The second comment concerns the large part of the report that was devoted to the proportion of unemployed that are receiving benefits. The Department questions whether this is a proper document to discuss this subject since it does not directly relate to the solvency issue. In addition, this GAO report will be released and become public at about the same time the draft report DOL commissioned Mathematica Policy Research to prepare on this subject will also become public. The Department feels that GAO's remarks are more in the nature of conjecture on the subject and do not represent the quantitative analysis used in the Mathematica study. There may also be some differences in the conclusions such that GAO might wish to examine their report and comment directly on that.

Related GAO Products

Unemployment Insurance: Issues Related to Reserve Adequacy and Trust Fund Solvency (GAO/T-HRD-88-23, July 7, 1988)

Unemployment Insurance: Issues Related to Reserve Adequacy and Trust Fund Solvency (GAO/T-HRD-88-6, Dec. 14, 1987)

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