UNEMPLOYMENT INSURANCE IN TRANSITION:

An Evaluation of the Impact of UI [illegible]

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A B S T R A C T

Three major issues concerning Unemployment Insurance--benefit adequacy, financing, and the impact on the unemployment--were studied by analyzing the impact of the program nationally and in California. The UI program was set up to enable workers to weather a spell of unemployment without making any drastic changes in their life styles such as selling their houses and moving, or selling cars or other durables. As a benchmark against which to measure benefits, the concept of short-run nondeferrable expenditures was defined and then estimated from two data sources for families in three income groups (lower-middle, middle, and upper). The UI wage replacement rates for workers from families in these three income groups with both one and two earners were then compared to the estimated nondeferrable expenditures. The results show than lower-middle and middle income families need a replacement rate above the current fifty percent rate in order to cover nondeferrable expenses if the family has only one earner. In addition, middle and upper income families need to have the maximum benefit increased in order to cover their nondeferrable expenditures when they have only one earner. In those families where both the husband and wife are employed, a fifty percent replacement rate will allow the family to cover its nondeferrable expenditures when the wife is unemployed. But the typical lower-middle income family will not be able to cover its nondeferrable expenditures when the husband is unemployed if his wage replacement rate is below sixty percent. In the middle and upper income families, when the husband is unemployed the maximum benefit ceiling is too low for the family to cover its nondeferrable expenditures. This research concludes that a fifty percent replacement rate is too

low for moderate and higher income families in the current UI program. The only spells of covered unemployment that do not cause financial hardship under the current UI program are those of wives or teenaged children in households with an employed male adult. This report recommends that benefits be restructured so that the replacement rate declines as earnings rise and that adjustments be made for the presence of other earners either through taxation of benefits or through allowances for dependents.

This report also recommends that the bias toward the seasonal industry and its unemployed workers should be reduced by basing the benefit calculation upon average annual earnings as well as high quarter earnings. The alternative approach of making the financing of the system completely experienced-rated is not recommended because of the problems of timing and because of the random element in cyclical-demand swings. Instead, the argument is made for experience-rating the Federal government by financing UI from general revenues for all unemployment above a designated "full employment" amount. This proposal is advocated on the grounds that recessions are induced by the Federal government in order to reduce inflation, which is a social good shared by all consumers. Therefore, the industries and workers who bear the burden of cyclical downturns should be subsidized by society.

The impact of the UI program on the unemployment rate during recessionary and full employment periods was explored. During periods when the number of job seekers outnumbers the available job slots, the Unemployment Insurance system may primarily affect the composition of the unemployed, rather than the level of unemployment. This outcome will result if UI recipients search longer for the next job (or wait for recall),

so that the available vacancies are taken by new or recent entrants or others who are not eligible for unemployment benefits. The increased job search of UI recipients will increase the unemployment rate only to the extent that it increases the actual duration of vacancies, and this effect should be important only during periods of full employment, if at all. The results reported here indicate that UI extends the duration of unemployment for experienced workers and decreases the duration of unemployment for inexperienced workers. Although the UI program does not give monetary aid directly to many unemployed, it does aid them through improving their access to vacancies that do not require work experience.

REPORT ON RESEARCH PROJECT

"Unemployment Insurance in Transition"

I. Activities

Preliminary results of this research project were given in a speech at the Conference on Income Support, Unemployment Insurance, and Guaranteed Jobs, which was co-sponsored by the San Francisco State University, the Employment and Training Administration, Department of Labor (Region IX), and the Department of Health, Education, and Welfare (Region IX) in February, 1976. The proceedings were published, and a copy is attached.

In spring of 1976, I met with the Director of the Employment Development Department of the State of California, Mr. Martin Glick, and advised him on the major areas of the California Unemployment Insurance System that needed reform. In particular, we talked about the seasonality problem and how California benefit payments, which are based on high quarter earnings, favor the seasonal worker.

Results from this research project were also presented in talks at a faculty luncheon at the Department of Economics and to the Labor Seminar, Economics 251, at the University of California, Berkeley.

Two other papers, which are attached, looked at specific problems in income support programs. The first, "The Changing Household: Implications for Devising an Income Support Program,: (Public Policy, Vol. 26, No. 2, Spring 1978) outlines the needs of various types of households and discusses the difficulties inherent in treating different groups fairly while maintaining work incentives as well as freedom of choice in forming households. The second paper, "The Importance of Cost-of-Living

Differentials for Income Support Programs," looks at the absolute and relative importance of cost-of-living and standard-of-living differences across regions and at how these two types of regional differences are reflected in wage structures and state income income support programs. Currently, this paper is being revised.

This report is based upon the working paper, "The Impact of Unemployment Insurance on the Unemployment Rate: A Disequilibrium Analysis." A final version of this paper will soon be available for circulation.

II. The Research

A. Background

The Unemployment Insurance Program, which has been the major income maintenance program for families with a member in the labor force, has recently been criticized as being "inadequate" by labor unions, "financially unsound" by administrators, and "too costly" by manufacturers associations. Economists, joining the attack upon the present system, have blamed UI for increasing the unemployment rate. The objective of the present research has been to re-orient the economic analysis of UI from the program's impact on search behavior to its performance as an income maintenance program during periods of depressed labor demand until workers are able to return to jobs reflecting their previous level of productivity. The impact of the UI system on the functioning of the labor market and on the distribution of income during periods of full employment and recession has been analyzed. In this research project, three major areas--benefits, financing, and the composition of unemployment--were studied by analyzing the impact of the program nationally and in California. This research has intended to help focus the present discussion of what the goal of UI should be versus what impact the system actually has and to provide information pertinent to analyzing possible reforms.

As the United States has been witnessing its worst economic slump since World War II, the social security programs designed to alleviate income losses during such periods have come under increasing attack. No program has weathered the impact of the current slump more poorly than the state-oriented Unemployment Insurance Program. At the same time that the UI system has been failing to achieve its original goals, these goals themselves have been questioned. At its inception in 1935, the Unemployment

Insurance Program was envisioned as a means for compensating workers for wage loss during periods of unemployment.[1] Two beneficial spinoffs of this were thought to be: a) stabilization of the work force as a result of experience-rated firm financing, and b) stabilization of the economy by maintaining the worker's purchasing power. The system was set up as an insurance program for workers suffering "normal" spells of unemployment; it was not intended to serve as a general income maintenance scheme for the long-term unemployed. Over the past forty years, the relative importance of these goals have changed; in the 1970's, the system has evolved more toward an income maintenance program for unemployed workers, without policy-makers explicitly recognizing the conflict inherent in simultaneously enacting a policy to maintain incomes and a policy to deflate the economy. During the current recession, the absence of a general income maintenance program has become more glaringly apparent to policy-makers. Concerned by the growing number of unemployed workers who were not drawing compensation, Congress has passed both temporary and permanent legislation since 1969 to extend the coverage and the benefit duration of UI. But large groups of the unemployed, particularly those whose work histories do not meet eligibility requirements (including new or recent entrants to the labor force), still remain uncovered. At best, these amendments can viewed as stopgap measures. The underlying question of what the major goals of Unemployment Insurance should be has yet to be resolved.

The experience of the mid-1970's has raised with new urgency fundamental questions about the UI system. These questions, which have generated heated discussions over the past forty years, include:

1. Should the UI system be viewed strictly as an insurance program or should it be viewed more broadly as a general income maintenance program for the unemployed? If alternative means of providing income maintenance are enacted, how should the UI system interface with this new program?

2. Should the federal government undertake an active role in setting standards for benefits, eligibility, duration, disqualifications, and coverage? If so, what levels should be set?

3. Should the program be funded through an experience-rated payroll tax on employers, or should alternative forms of financing be used? This old financing question has become increasingly important since more than thirty states have recently depleted their trust funds.

During the early years of the UI program, economists were concerned primarily with studying the administration of the system. Their research, which was descriptive in nature, increased our understanding of the institutional aspects of the system.[2] More recently, economists have turned to studying the impact of the UI program on the functioning of the labor market. Their emphasis has been on measuring the influence of UI benefits on the job search behavior of covered workers and the resulting impact on the unemployment rate.[3] These studies have been aimed almost exclusively at estimating how the UI program affects the efficient functioning of the labor market within an implicit full-employment economy. But with most economists forecasting unemployment rates exceeding five percent for several years to come, the concern about the welfare loss resulting from the inefficient market operation at the margin should take a back seat to the broader question of the economic impact of the program, which usually operates in a less than full-employment economy.

B. Research Findings

The findings of this research project will be divided into three areas. First, the benefit structure--both its level of adequacy and its impact on work incentives of recipients--will be analyzed. Second, the importance of experience-rating for affecting the firm's layoff behavior will be discussed. Third, the impact of the Unemployment Insurance Program on the unemployment rate and on the composition of the unemployed will be analyzed.

1. Benefit Adequacy

One way the UI system influences the functioning of the labor market is through its impact upon job search behavior. A goal of the program is to maintain a worker's income during periods of unemployment while he or she waits out a temporary layoff until recalled or, if recall does not seem probable, while he or she engages in job search, which hopefully will result in the person's finding a suitable job (i.e., a job that reflects the worker's skills and past productivity). The compensation payment supposedly will prevent an unemployed person from having to bow to short-run financial pressures by accepting menial, temporary jobs or a permanent job that does not utilize his or her skills. Because of the waiting period, low monetary payments, limitations on duration, and administrative regulations of the program, as well as the implicit bad reputation that accompanies a record with above average turnover and periods of unemployment, few observers believe that the UI system has much influence on an unemployed worker's decision to remain on the job or to enter unemployment. But by changing the cost of being unemployed, the program does influence the unemployed worker's decisions about whether to wait for an expected recall, how long and how intensively to search for a job, and what

constitutes an acceptable job (i.e., his or her requirements for wages and working conditions). For this reason, the existence of the UI system does affect the matching of workers and jobs.

Unfortunately, many of the economic studies dealing with the effects of UI on the duration of unemployment have implicitly assumed that the only deterrent to an unemployed worker's accepting a job is the worker's own willingness to return to work. In this type of full-employment model, the maximum replacement rate (i.e., the percent of take-home pay that is replaced by unemployment compensation) is used to judge the work disincentive effect of the program. Besides the fact that suitable jobs for an unemployed worker may be scarce so that he or she cannot decide to return to work whenever desired, this approach is misleading for at least two reasons:

1. The program does not operate in an administrative vacuum. Elligibility for UI is affected by the reason a claimant is unemployed. In most states workers who quit a job are not eligible or must suffer waiting penalties, and workers who are fired for cause are not eligible. Furthermore, a claimant who is not engaged in job search or who is not willing to take a suitable job when offered can be disqualified. Of course, the states' eligibility and disqualification regulations cover a broad spectrum, and the states show enormous variation in the administration of their laws. Although the replacement rate may give an indication of the work disincentive effect for the unemployed worker in the very short run once the initial waiting period is over, these administrative rules and the duration limitation prevent the replacement rate from being the only cost influence on the worker's search behavior during his or her period of unemployment.

2. The hardship suffered by a household during periods of income loss cannot be judged solely by the replacement ratio. This ratio must be compared to some indicator of the family's economic adaptability in the short run. Its ability to make short-run adjustments to an economic loss can be indicated by the percent of its monthly income that is spent on "uncontrollable expenditures," or those expenditures to which it has already committed itself or which are for necessities. The major components of these expenditures include rent or mortgage payments, car and other installment payments, medical expenses, life insurance, food, and other necessary living expenses. Since most families do not have the assets necessary to enable them to borrow or to meet living expenses out of savings, if the uncontrollable expenditures are much larger than their unemployment compensation, they cannot continue on UI for very long without making drastic changes in their expenditure patters.

The liquid assets position of most families does not allow them to draw from savings for very long. In 1970, only one in six families did not have any liquid assets (savings accounts, CD's, checking accounts, and government savings bonds), but the value of assets for families with such forms of wealth was relatively small. One in four households had liquid assets worth $1 - $500, and one in five households had liquid assets worth over $5000. The median value of liquid assets for all households was $800. Almost 60 percent of all families have yearly incomes between $5000 to $15,000, and 11 percent of them had no liquid assets. But even one-half of the families with incomes between $10,000 to $15,000 had liquid assets worth less than $1200 (See Table A.) These figures indicate that although most families have some liquid assets available for emer-

Table A

Median Liquid Assets by Income Class, 1970

Total Family Income	Distribution of Families	No Liquid Assets	Value of liquid Assets (median)
< $3000	8.9%	42%	$ 50
$3000 - $4999	10.4	30	250
$5000 - $7499	15.1	22	300
$7500 - $9999	16.6	12	500
$10,000 - $14,999	26.8	5	1200
$15,000 +	22.3	1	3700

Median Family Income: $9867.

Source: George Katora, L. Mandell, Schimiedeskamp, 1970 Survey of Consumer Finances, Survey Research Center, University of Michigan, Ann Arbor, 1971, Tables 6-3, 6-4, and Bureau of the Census, Statistical Abstract of the United States: 1976. (97th edition). Washington, D.C., No. 647.

gencies, the value of such funds is extremely low relative to the income needed to meet their monthly financial commitments (calculated below).

In fact, the UI system was set up to enable workers to weather a spell of unemployment without making any drastic changes in their life styles such as selling their house and moving, or selling a car or other durables. In addition to the expenditure of energy and the emotional trauma that accompanies such changes, these expenditure shifts have high transaction costs that are inefficient if the worker's long-run earnings have not fallen. As long as nondeferrable expenses can be met, then unemployed workers' families can remain in their homes or apartments, and can continue to meet car, medical, and life insurance payments. They would be expected to make some changes in other expenditures, such as food and recreation, but they should not be expected to make drastic changes in the way they live if this entails a large investment in learning (such as meal preparation) or if it entails major psychological adjustments during the supposedly short period of unemployment. In order to establish a benchmark for the proportion of family income that might be classified today as nondeferrable, I estimated uncontrollable expenditures based upon the Department of Labor's three hypothetical budgets for an urban family of four persons (see Table 1). The following assumptions were made: shelter, medical care, and life insurance costs remain constant, food cost and transportation cost decline by ten to thirty percent, depending upon the level of the budget; expenditures for household operations, personal care, and other consumption are assumed to be minimal. Nondeferrable expenditures as a proportion of total expenditures for three budget types (lower, moderage, and higher) were .71, .61, and

.50 respectively.[4] This means that the moderate income family needs at least 60 percent of its gross income to meet its financial commitments. If the family has only one earner, then these proportions represent the gross replacement rate necessary for the family to cover its non-deferrable expenditures. The necessary replacement rate can be lower if the household has other sources of income or more than one earner. The assumptions used in making these calculations are conservative, but these benchmarks indicate that a two-thirds replacement rate up to a ceiling of two-thirds the average wage, which is advocated by many groups, is not out of line with sufficient income to meet nondeferrable expenses.

Another benchmark for nondeferrable expenditures was estimated using the Consumer Expenditure Survey of 1972-73.[5] Tabulations made from the 1972 interview tapes on ten thousand households indicate that the gross replacement rates for lower-middle ($6,000 - $10,999), middle ($11,000 - $16,999), and upper-middle ($17,000 - $35,000) income families are lower than the rates estimated from the Department of Labor budgets; they would be .65, .54. and .45 respectively. (See Table 2). If a family's income is provided solely by the earnings of one worker, then these ratios represent the gross earnings replacement rate needed to cover its nondeferrable expenses. In the typical state that provides a replacement rate of 50 percent of previous earnings, the benefits received by a lower-middle income, one-earner family are not sufficient to cover its short-run financial obligations. The benefits for middle income families with one earner would almost cover their short-run obligations, and the benefits for upper-middle income families would slightly exceed their short-run obligations. But all states have a

Table 1

Calculation of Nondeferrable Expenditures for Three Hypothetical Budgets for an Urban Family of Four Persons, 1967

Item	Lower	Moderate	Higher
Food	$1480	$1684	$1810
Housing			
Shelter	1013	1745	2308
House Furnishings	00	00	00
Household Operations	153	153	153
Transportation	357	654	845
Clothing			
Adult	00	00	00
Children	59	59	59
Maintenance	48	48	48
Personal Care	162	162	162
Medical Care	474	477	497
Other Consumption	265	265	265
Gifts and Contributions	73	125	163
Life Insurance	120	160	240
TOTAL NONDEFERRABLE EXPENDITURES	$4204	$5532	$6550
Total Budget	$5915	$9076	$13,050
Occupational Expenses, Income and payroll taxes	788	1445	2,357
Net Budget	$5127	$7631	$10,693
Nondeferrable expenditures as a proportion of:			
Total Budget	.71	.61	.50
Net Budget	.82	.72	.61

Source: The budget figures are taken from "3 Standards of Living for an Urban Family of Four Persons, Spring 1967," U.S. Bureau of Labor Statistics, Bulletin No. 1570-5, 1969. The following assumptions were made in calculating the nondeferrable expenditures:

Assumptions used:

The food budgets were decreased by 10, 20, and 30 percent for the lower, moderate, and higher budgets, respectively.

Shelter costs (rent or mortgage) remained the same. All budgets were allowed the same amount for household operations as the lower budget; nothing was allowed for house furnishings.

Transportation expenses were decreased by 25 percent in the three budgets.

Expenditures on children's clothing were decreased by one-half and the maintenance costs remained the same in the lower budget; the moderate and higher budgets were allowed the same amounts for children's clothing and maintenance as in the lower budget. No money was allotted for adult's clothing.

All three budgets were allowed the same amount for personal care as in the lower budget.

Medical care expenses remained the same.

Other consumption, primarily leisure and educational activities, was reduced 10 percent in the lower budget, and the same amount was allowed in the moderate and higher budgets.

Gifts and contributions were reduced by one-half in the lower and moderate budgets and by two-thirds in the higher budget.

Life insurance expenses remained the same.

Occupational expenses and taxes include work related expenses (such as union dues) and income and property taxes.

ceiling on weekly benefit payments, so that we cannot judge benefit adequacy solely by the replacement rate. In order for these two types of families to cover their nondeferrable expenditures, they need an average weekly income of $140 and $185, respectively. But, in fact, none of the states (including D.C.) provided benefits high enough to cover the nondeferrable expenditures of middle or upper-middle income families.[6]

But 85 percent of the families in 1972 were headed by a husband-wife, and in over 40 percent of these families the wife was in the paid labor force.[7a] Since the source of earnings is available in the CEX data set, it was used to estimate the impact of a 50 percent wage replacement rate on husband-wife families with both the husband and wife employed. In the 1972 CEX sample used, the percent of husband-wife families with the wife employed was 36 percent for lower-middle income, 47 percent for middle income, and 58 percent for upper-middle income families. For those families with lower-middle incomes ($6,000 - $11,000) and the wife employed, the wife's earnings are approximately 30 percent of total family earnings. If the wife becomes unemployed and collects unemployment compensation equal to fifty percent of her gross wages, then the family can meet nondeferrable expenditures as long as the payroll taxes and incomes taxes paid by the employed husband are less than thirty percent, which is currently the case.[7b] But if the husband (rather than the wife) becomes unemployed and receives unemployment benefits equal to fifty percent of his gross earnings, whenever the wife has any taxes on her earnings, the family cannot meet its nondeferrable expenditures. In other words, the family would need the fifty percent replacement rate on the husband's earnings plus all of the wife's earnings

in order to have sixty-five percent of its normal income, which is spent on nondeferrable items.[7c] If the wife has an average tax rate of only twelve percent (for both income and payroll taxes), then the husband would need a wage replacement rate of sixty percent in order for this lower-middle income family to meet its nondeferrable expenditures.[7d]

For those families with middle incomes ($11,00 - $17,000) and an employed wife, the wife's earnings represent 25 percent of the total family earnings. An average family in this middle-income group was estimated to need only fifty-four percent of its normal income to meet nondeferrable expenditures. If the wife collects unemployment benefits equal to one-half of her normal earnings, then the family can meet its nondeferrable expenditures whenever the average tax rate on the husband's earnings is less than forty-five percent, which is currently the case. Families with employed wives can also meet their nondeferrable expenditures when the husband in unemployed. If the husband is collecting unemployment compensation and receives a fifty percent earning replacement, then this family can continue to meet their nondeferrable expenditures provided the tax rate on the wife's earnings is less than thirty-six percent, which is the case under the current tax structure.[7e] But this last case with the unemployed husband holds only if the husband's fifty percent earnings replacement rate is not constrained by a ceiling on benefits. Whenever the maximum benefit is less than $89 per week, the family's weekly income will fall below that needed to cover nondeferrable expenditures.[8] This was the situation in 1972, in 43 states where the maximum weekly benefit was below $89.[9] In general, two-earner families in this moderate income group are constrained by the ceiling on benefits

Table 2

Calculations of Nondeferrable Expenditures[a/]
for Three Income Groups for a Family of Four, 1972

	Average Annual Income	%Spent on Nondeferrable Expenditures
Husband-Homemaker Families		
Income Group		
I. Lower Middle	$ 9046	64%
II. Middle	13584	54
III. Upper Middle	21373	45
Husband-Employed Wife Families		
Income Group		
I. Lower Middle	$ 9101	65%
II. Middle	14149	54
III. Upper Middle	22446	44

Source: The interview survey tapes of the 1972-73 Consumer Expenditure Survey.

a/ Nondeferrable expenditures include food, shelter, fuel and utilities telephone, drycleaning and laundry, clothing repairs, transportation, health expenses, reading, education, and insurance premiums. They exclude alcohol and tobacco, domestic services, house furnishings and equipment, clothing, personal care, recreation, miscellaneous, retirement premiums, and gifts and contributions. Notice that this definition is not the same as the one used in Table 1; in comparison, the definition used in this table provides a cruder approximation.

rather than the replacement rate for receiving benefits adequate to cover their nondeferrable expenses.

The outcome for the upper-middle income group ($17,000 - $35,000) follows the same pattern as the middle income group. When the unemployed wife collects UI, the husband's income will still cover the family's nondeferrable expenditures, which are only 44 percent of the family's income. But if the husband is unemployed, his unemployment benefits must equal at least $91.00 per week for the family to meet its non-deferrable expenditures. In fact, 43 states paid a maximum weekly benefit below $91 in 1972.[10]

These comparisons of estimated nondeferrable expenditures and UI benefits indicate that a 50 percent replacement rate is not sufficient to cover the financial commitments for a lower-middle or middle income family with only one earner or a lower-middle income family with two-earners when the husband is unemployed. In these situations, the earnings replacement rate must be 54 to 71 percent in order to provide an income flow at least equal to the family's nondeferrable expenditures. Although the earnings replacement rate of 50 percent would be sufficient for the other household types, in fact these families do not receive this average rate because of the ceiling placed on benefits. In 1972, the ceiling on UI benefits was so low that even the two-earner, middle-income family with an unemployed husband could not meet nondeferrable expenditures with the wife's earnings and the husband's benefits. These calculations show that under the current UI system both one-earner and two-earner families suffer a real financial squeeze when the head is unemployed unless they have liquid assets to draw upon. These assets must cover

the waiting period (when no UI benefits are forthcoming) as well as the difference between the nondeferrable expenses and the family's decreased income while the head is unemployed. In contrast, if the wife is unemployed but her husband is employed, then her UI benefits are sufficient for the family's income to cover its nondeferrable expenditures.

2. Seasonality problems

The seasonality issue arises from the method used to establish a worker's previous earnings, which determines the weekly benefit amount. Primarily two approaches are used--high quarter earnings, which favor seasonal workers, and average annual earnings, which hurt seasonal workers. In 1972, thirty-five states and Washington D.C. used the high-quarter approach.[11] California provides a good case study of how the high-quarter earnings approach exacerbates the seasonality problem, since under such a system there are large rewards to having all one's earnings in one quarter. For example, any worker who earned $3308 in the high quarter would have been eligible for the maximum weekly benefits of $104 in 1976. (See Table 3) To have been eligible for the maximum duration of twenty-six weeks, one must have earned $5408 in the base year period. For example, a worker who had base period earnings equal to $3308, all earned in one quarter, would have been eligible to receive the maximum weekly benefit of $104 for sixteen weeks under the regular state program (plus the Federal-state extensions in effect). The steady worker with $5408 in base period earnings (or $1352 in each quarter) would have been eligible for twenty-six week of UI benefits, but his or her weekly benefit would have been only $52. The claimant who earned $3308 in the high quarter and a total of $5408 in the base period would

Table 3

Examples of UI Benefits Received in California, 1976

	Worker's Previous Earnings in		Weekly Benefits	Maximum Duration (weeks) [a]	Total Allowable Benefits
	High Quarter	Base Period			
Case 1	$3308	$3308	$104	15+	$1654
Case 2	1352	5408	52	26	1352
Case 3	3308	5408	104	26	2704
Case 4	3308	13232	104	26	2704

Source: The Employment Development Department, State of California, Berkeley Branch.

a/ This is the maximum duration under the regular state program. At the time, Federal-State extensions of 13 weeks (maximum) and Federal extensions of an additional 26 weeks (maximum) were in effect.

have been eligible for weekly benefits of $104 for twenty-six weeks. These are the identical benefits available to the steady worker who has earnings of $3308 in each quarter with base period earnings of $13,232. As a result of this bias toward seasonal workers, the unemployed in agriculture and related industries, contract construction, and motion pictures receive a disproportionate amount of the unemployment benefits. (See Table 4) For example, over the ten year period from 1965 through 1974, the contract construction industry accounted for 8 percent of all wages in covered industries,[12] and 18 percent of all UI benefits collected. (See Table 4) In 1974, the deficit of benefits over contributions for contract construction amounted to $91 million. Agriculture, forestry, food, and related industries made 6 percent of the contributions while their unemployed workers collected 11 percent of the benefits. The agricultural deficit in 1974, which was before farmworkers were covered, equalled $45 million. For fisheries, canneries, and loggers, the excess of UI benefits over contributions actually provides an appreciable proportion (5 to 8 percent) of the average wages. These deficits are offset by the surpluses (i.e., the excess contributions paid by employers over the benefits collected by workers) of the less seasonal and more stable sectors of retail trade, finance and real estate, and health services.

In 1973, only 10 percent of the UI recipients in California had their base period earnings fall in one quarter, while almost 70 percent of the UI recipients had base period earnings at least 3.5 times their high quarter earnings. Over 60 percent had high-quarter earnings greater than $3000 and base period earnings greater than $10,000.[13] These 1973

Table 4

Industries in California
Net Gainers and Losers in the UI System
1965-1974 Averages

INDUSTRY	Wages as a % of Total Wages (1)	UI Benefits Paid as a % of Total Benefits (2)	Employer Contributions as a % of Total Contributions (3)	Benefits-Contributions as a % of Wages (4)
All Industry[a/]	100.0	100.0	100.0	0.0
Agriculture and Forestry	0.6	1.5	0.8	1.6
Contract Sorting	0.5	1.2	0.8	1.1
Fisheries	0.1	0.3	0.1	5.7
Contract-Construction	8.0	17.8	10.0	1.3
Nondurable Goods	10.1	13.4	10.1	0.5
Food and Kindred Products	3.4	7.4	3.8	1.4
Canning and Preserving fruits, vegetables, and seafoods	1.0	4.9	1.6	4.6
Apparal and other finished products made from fabric	0.1	2.2	1.6	0.9
Printing, Publishing and allied industries	1.8	1.1	1.5	-0.3
Rubber and misc. plastics	0.8	0.7	0.9	-0.3
Ordnance and Accessories	2.1	0.9	1.4	-0.3

Table 4 continued

	(1)	(2)	(3)	(4)
Lumber and Wood (except furniture)	1.0	2.3	1.3	1.4
Logging camps and contractors	0.1	0.7	0.2	8.1
Machinery (except electrical)	3.2	2.0	2.8	-0.3
Electrical Machinery equipment and supplies	5.7	4.3	4.8	-0.1
Transportation equipment	5.9	5.7	5.1	0.1
Professional, scientific, and controlling instruments	0.8	0.5	0.7	-0.4
Transportation, Communication Electric, Gas and Sanitary Services	9.4	5.2	6.8	-0.2
Transportation by air	1.7	0.5	1.0	-0.4
Communication	2.9	0.8	1.7	-0.4
Electric, gas, and sanitary services	1.5	0.3	0.8	-.04
Wholesale Trade	8.7	6.2	7.4	-.02
Retail Trade	14.9	14.5	18.1	-.03

Table 4 continued

	(1)	(2)	(3)	(4)
Finance, Insurance and Real Estate	6.8	3.4	5.7	-0.5
Banking	1.9	0.6	1.5	-0.7
Insurance Carriers	1.7	0.7	1.3	-0.5
Services	15.5	15.6	17.7	-0.2
Motion Pictures	1.4	2.4	1.4	1.1
Medical and other health services	3.3	1.7	3.6	-0.8
Legal services	0.5	0.2	0.5	-0.7

Source: Calculated from Employment Development Department, State of California, Report 352, Final Report, February 24, 1976.

a/ The ten year averages for all industries were: wages ($41,641,251,512); UI benefits paid ($583,107,958); employer contributions ($586,170,760).

figures indicate that only a small proportion of the recipients were one-quarter earners, that a large majority of claimants were eligible for both the maximum benefit and the maximum duration, and that one-third of the recipients were laid off one quarter or more per year. In the early 1970's, a study of the seasonal patterns of unemployment compensation in California was made using a sample of UI recipients in 1967, 1968, and 1969. This study found that a large minority of the UI claimants received some benefits annually--31 percent of the claimants in 1969 also received UI benefits in 1967 and in 1968. In addition, over half of the UI recipients in 1969 had also received benefits in 1967 and 1968 if they worked in agriculture, contract construction, canning and preserving, motor vehicles, or apparel.[14] This study happened to be conducted during a full-employment period; and, as I discuss below, the seasonality issue becomes especially important as the economy approaches full employment.

The seasonality problem is not a small problem for many states, including California. Some states have tried to tackle the problem through defining benefit payments based upon annual earnings or have denied benefits to seasonal workers (such as in Florida). One of the distribution consequences encountered in trying to minimize the seasonality problem in the UI system is that both high-wage and low-wage workers, ranging from high-skilled construction workers to low-skilled farm workers, are engaged in seasonal employment. For example, the benefit amount paid to an average claimant engaged in agriculture was $605 over a period of 12.3 weeks while the median earnings in this industrial division was only $2,250 a year. The average amount paid

to a recipient in contract construction was $719 over 11.7 weeks, while the median earnings in this industry were $7,940 in 1970.[15] Since the labor and product markets differ in these two industries, changing the UI laws will affect wage and price structures of these two industries differently. This, along with the distributional consequences, must be taken into consideration in evaluating any proposals to deal with the seasonality issue.

3. Financing

Many economists, notably Feldstein,[16] have urged that the seasonality problem of the Unemployment Insurance system be tackled through completely experience-rating the payroll tax that employers pay. The payroll tax has some experience-rated components. These became part of the program legislated in 1935, primarily at the urging of Professor Commons, who argued that such an experience-rated tax would decrease the propensity of employers to engage in short-term layoffs. In fact, though, the system is not truly experience-rated because the majority of the firms pay near the top tax rate in most states, and seasonal and cyclical industries run deficits while more stable industries run surpluses. But there are many reasons why a completely experienced-rated payroll tax may not be the best way to pay for Unemployment Insurance in a dynamic economy. Taken to the extreme, an experience-rated system is equivalent to a separate fund for each firm. The only role the government plays in this system is to establish the rules by which the firms are forced to pay their laid-off workers. Such an experience-rated system poses several problems. The declining industry will pay its way out in bankruptcy, and an experience-rated system will only hasten its decline.

Also, who should pay for the dislocations caused by government policies--for example, changing tariffs, changes in government demand (such as for defense goods), changes in government regulations (such as in airlines), and changes in government monetary policy (such as in housing)--is unclear. Especially in those industries affected by government actions that are designed to decrease demand in order to offset inflationary pressures, the whole citizenry, which benefits from price stability, should share the cost of the short-run decline in demand rather than the workers and capital owners in the striken industry. Traditionally, the construction sector and the durable manufacturing sectors have born more than their share of the decline in demand in a government-induced recession. Since the relative decline in demand differs for each cycle, these random cyclical impacts should not be included in the long run relative wage structure. Yet a true experience-rated system would force these cyclical impacts to be reflected in the wage and price structure in the short run, although not necessarily in the long run. For these reasons, one may want to experience-rate the seasonal fluctuation but not the cyclical fluctuations in the work force. But it is difficult to distinguish seasonal changes that would occur at full employment from the seasonal changes that do occur along with the continual cyclical and secular changes.

Timing also poses a problem in an experience-rated system. The firm will pay for current layoffs at some time in the future even in a true experience-rated system, because to tax them for layoffs at the time of the layoff would be administratively impossible and would aggravate the cycle. But allowing them to pay for their layoffs in the

future weakens the connection between actions now and costs later if the managers are primarily concerned with yearly performance. In addition, the unemployment duration of the laid-off workers is not entirely withing the control of the employer. Employers in areas of higher unemployment will pay more for a layoff since the probability of the worker finding another job is lower.

The incidence of the payroll tax, which is difficult to predict, depends upon the extent of unionization of the industries, upon the concentration of the firms and their market power, and upon the tax rates across states, which vary widely both in the degree of experience-rating and in the tax schedule in effect. In most states, the tax paid by a firm depends more upon the solvency of the state's Unemployment Insurance fund rather than the past experience of the firm in its layoffs. For example, in California, the major changes in the tax rate faced by employers depend upon the actual tax table in force at any given time, since this sets the general level of the tax. These arguments indicate that a pure experience-rated system may not be a panacea to solving some of the efficiency problems that are the outcome of a static, competitive economic model. We should be cautious in attempting to tackle the seasonality problem through pure experience-rating, since it may aggravate other problems, such as the cyclical impact of the Unemployment Insurance.

4. Impact on Unemployment Rate

Recent economic analysis of the Unemployment Insurance system has been focused on showing how much UI increases the unemployment rate. But a great deal of confusion exists about how UI actually increases the unemployment rate, especially during recessionary periods. The Unemployment Insurance system increases the amount of observed unemployment, primarily in three ways.

1. UI may increase the amount of seasonal unemployment by encouraging firms to vary their work forces more than they might otherwise since seasonal layoffs are subsidized through the UI deficits of these industries.

2. The presence of Unemployment Insurance may delay the planned dropping-out of the labor force by people who claim to be looking for jobs when actually they have withdrawn from the labor market while collecting UI.

3. Unemployment benefits may encourage the unemployed worker to prolong his or her job search so that the length of time it takes an employer to fill a job vacancy increases.

During periods when the number of job seekers outnumber the available job slots, the Unemployment Insurance system may primarily affect the composition of the unemployed, rather than the level of unemployment. This outcome occurs as a result of UI recipients waiting to be recalled or searching longer for their next job so that job seekers not eligible for UI have improved access to the available vacancies. Since the unemployed who are not eligible for UI are primarily new or recent entrants into the labor market, the jobs for which they are quali-

fied are less skilled. Supposedly, the UI system was created so that experienced unemployed workers collecting UI would not take these less-skilled jobs on a temporary basis while they waited to return to jobs that utilized their skills and experience. On the other hand, UI claimants would be expected to fill the higher-skilled vacancies when available since these types of jobs are not available upon demand and, as shown above, the spell of unemployment places financial pressures upon most families. If the UI system is functioning properly, UI claimants should have longer spells of unemployment than non-UI claimants during a period of deficient demand for labor. But the increased unemployment durations of UI recipients will increase the unemployment rate only to the extent that it increases the actual duration of vacancies.[17] Although the effect upon the vacancy duration may be important during full employment periods, during recessionary periods the increased search time of UI recipients should not increase the duration of vacancies, unless recipients pass up "suitable" jobs so that a large number of highly skilled vacancies go begging.

Vacancy data are needed in order to analyze precisely how the UI system affects the level and composition of unemployment, but the vacancy data in this country are inadequate for such an analysis.[18] In the absence of vacancy data on the number and skill level of job openings, the data on unemployment spells and duration for job losers, leavers, re-entrants, and new entrants provide the best source for analyzing the impact of UI on the distribution of unemployment. Although vacancy data are necessary to answer the question of how much UI increases the duration of vacancies, and therefore the unemployment rate, the unem-

ployment data at least indicates whether UI increases the unemployment duration of recipients but decreases the unemployment duration of non-recipients.

In order to understand the impact of UI on the composition of unemployment, consider the simple world with two types of workers and two types of jobs: skilled (subscripted s) and unskilled (subscripted n). Assume the skilled unemployed workers (U_s) can fill both skilled vacancies (V_s) and unskilled vacancies (V_n), the unskilled unemployed (U_n) can fill only unskilled vacancies, and the employer is indifferent between skilled and unskilled workers in filling unskilled jobs. The impact of UI on the unemployment of these two groups will depend upon the state of the labor market.

Period of full employment ($U_n = V_n$ and $U_s = V_s$). If U_s accepts only skilled jobs, then the skilled and unskilled workers operate in separate markets. In the steady state the average duration of unemployment (DUR_u) equals the average duration of vacancies (DUR_v) in both the skilled and the unskilled markets. Therefore, the ratio of the unemployment duration of the skilled unemployed to the unskilled unemployed equals the duration of skilled vacancies to unskilled vacancies, or

$$\frac{DUR_{u_s}}{DUR_{u_n}} = \frac{DUR_{v_s}}{DUR_{v_n}} .$$

In this steady-state full-employment situation, the ratio of the average durations of unemployment (or vacancies) depends upon the amount of

time it takes to match workers and jobs. Although this relationship holds whether or not a program exists to pay unemployment compensation to the skilled workers (but not the unskilled) the existence of UI would increase the ratio by increasing the duration of unemployment for skilled workers if it increased their search time.

Period of recession ($U_n > V_n$ and $U_s > V_s$). Without a system of unemployment compensation, assume that a skilled unemployed worker accepts any job offered (skilled or unskilled), that unskilled workers are offered only unskilled jobs, and that skilled and unskilled workers have equal probability of receiving an unskilled job offer.

$$\frac{DUR_{u_s}}{DUR_{u_n}} = \frac{\gamma_n V_n}{U_s+U_n} \div \left(\frac{\gamma_s V_s}{U_s} + \frac{\gamma_n V_n}{(U_s+U_n)}\right) ,$$

where γ_i represents the proportion of vacancies filled each period (i = skilled, unskilled). Clearly, this ratio is less than 1. But if unemployment compensation is available to the skilled workers (but not the unskilled), then assume the skilled workers accept only skilled jobs. In this case the skilled workers do not search for unskilled jobs, and so the skilled and unskilled workers operate in segmented markets (as in the full employment case). Then,

$$\frac{DUR_{u_s}}{DUR_{u_n}} = \frac{U_s(\gamma_n V_n)}{U_n(\gamma_s V_s)} = \frac{U_s DUR_{v_s} V_n}{U_n DUR_{v_n} V_s}$$

Although, $U_s > U_n$ in a recessionary period, whether the ratio of the duration is greater or less than 1 is uncertain.

Although this model represents an extreme version of a world where UI recipients are skilled workers eligible for all jobs and nonrecipients

are unskilled workers, the direction of the results holds for a more realistic world with the following characteristics:

1. There are two groups of unemployed workers, those eligible for unemployment compensation and those ineligible.

2. The average skill level of jobs open to UI recipients is greater than the skill level of the jobs open to nonrecipients.

In order to compare the average unemployment duration of various types of workers, three periods of varying levels of labor demand were chosen: 1969, a period of high demand for labor with a total unemployment rate of 3.5%; 1971, a recessionary period with the unemployment rate of 5.9%; 1975, a major recession with unemployment 8.5%. Although the unemployed cannot be precisely divided into UI recipients and nonrecipients, the existence of UI eligibility rules allow us to use the reason for unemployment to classify people according to whether or not they would be expected to receive UI. The unemployed are divided into four groups by their reason given for being unemployed: job losers (people involuntarily laid off), job leavers (people voluntarily quitting their jobs), re-entrants (people with previous work experience who are entering the labor market), and new entrants (people without previous work experience who are entering the labor market). The job losers are assumed to be receiving UI, while the other groups are assumed not to be eligible for UI. These categorizations are not precisely correct since some quitters and re-entrants may actually qualify for UI in some cases and some losers may not not qualify for UI because of insufficient wages or work experience or because they have exhausted their UI benefits. But this classification scheme

should provide a close approximation for identifying UI recipients and nonrecipients, especially for losers and new entrants, respectively. Table 5 gives the unemployment duration distribution for these four groups, and Table 6 gives the ratio of their estimated average durations. Comparing losers with new entrants corresponds to comparing the skilled worker eligible for UI benefits with the unskilled worker not eligible for UI. The average duration of unemployment for the losers was 30 percent higher than for the new entrants during the high demand period of 1969, which indicates that matching skilled workers and jobs takes longer than matching unskilled workers and jobs. This ratio increases as the unemployment rate rises, so that the duration of unemployment for the loser was 54 percent greater than the duration for new entrants in 1975. This is what our simple model predicted would occur with an unemployment compensation system that keeps experienced workers waiting to return to jobs that utilize their skills while the inexperienced workers have access to the job vacancies that do not require experience. Although the duration of unemployment of both losers and new entrants increases during periods of deficient demand for labor, the unemployment duration for job losers increases much more.

A comparison of job losers to job leavers gives a rough estimate of the differences in job search time for experienced workers with and without unemployment compensation, respectively. But these two groups vary in significant ways, since leavers are voluntarily separating from their jobs. They plan their separations and those who line up a new job before quitting their present jobs are not included; hence, the significant group of those who search while employed is excluded. But

Table 5

Duration of Unemployment by Reason,
1969, 1971, and 1975.

Reason for Unemployment	Percent of Total Unemployment	Duration of Unemployment (weeks) <5	5-14	15-26	27+	Estimated Mean Duration a/ (weeks)
1969						
Losers	36%	51%	32%	12%	6%	9.0
Leavers	15	61	28	7	4	7.4
Re-entrants	34	62	26	7	4	7.2
New Entrants	15	60	31	6	3	6.9
1971						
Losers	46%	36%	33%	17%	14%	13.1
Leavers	12	46	33	13	8	10.2
Re-entrants	29	54	30	9	7	8.8
New Entrants	13	52	32	9	7	9.0
1975						
Losers	55%	29%	32%	20%	19%	15.4
Leavers	10	41	30	14	15	12.8
Re-entrants	24	48	30	12	10	10.4
New Entrants	10	48	33	11	8	10.0

Source: U.S. Bureau of Labor Statistics, Employment and Earnings, January 1970 (Tables A-10, A-11, A-12), January 1972 (Tables A-10, A-11, A-12), and January 1976 (Tables 10, 14).

a/ Mean durations were estimated by assuming the average duration in each group by weeks was at the midpoint (i.e. 2.5 weeks for group < 5 weeks, 9.5 weeks for group 5-14 weeks, 20.5 weeks for group 15-26 weeks), and the average for the 27+ weeks group was 40 weeks. Under these assumptions, the estimated average duration of the total unemployed was 7.9 weeks (1969), 11.0 weeks (1971), and 13.4 weeks (1975). The actual average durations were 7.9, 11.4, and 14.1, respectively. Thus, these estimated durations are too low for periods of high unemployment.

Table 6

Ratios of Average Unemployment Duration

Ratio of Average Duration for:	1969	1971	1975
Losers to New Entrants	1.30	1.46	1.54
Losers to Re-entrants	1.25	1.49	1.48
Losers to Leavers	1.22	1.28	1.20
Leavers to New Entrants	1.07	1.13	1.28

once job losers and leavers enter unemployment, the duration of unemployment for losers is 20 to 28 percent higher than for leavers. The presence of UI benefits for losers and not for leavers would lead us to expect the duration of unemployment to be higher for the group with income support, which also includes those who are waiting to be recalled. But the cyclical variation in their durations could not be predicted; in fact, the ratio of the duration shows no systematic variation over the cycle.

A comparison of leavers to new entrants gives an approximation of the duration of unemployment for experienced workers and inexperienced workers in the situation where neither group is eligible for compensation. The model above predicted that as the demand for labor decreased, the duration of unemployment for experienced workers compared to inexperienced workers would decline. In fact, the opposite occurs--as the unemployment rate increases the average duration of unemployment for leavers increases more than the duration for new entrants. The increase in average duration of unemployment for leavers is primarily effected through the proportion of persons unemployed more than 14 weeks increasing from 12 percent in 1969 to 29 percent in 1975. Meanwhile, the new entrants who are unemployed more than 14 weeks increased from 9 percent to 20 percent. This smaller increase in long-run unemployment for new entrants may be explained by the fact that many of the new entrants are looking for after-school jobs or summer jobs, and these young people tend to drop out of the labor market if such jobs do not materialize withing a couple of months. But for each period shown, the ratio of unemployment durations for job losers to new entrants

is considerably higher than for job leavers to new entrants, which is what the model predicts.

The unemployment duration data indicate that the existence of unemployment compensation increases the duration of unemployment for eligible persons during a period of full employment and allows the inexperienced unemployed access to vacancies during recessionary periods. To what extent the existence of UI increases the unemployment rate during slack periods cannot be determined, but comparing the duration of unemployment for recipients to nonrecipients indicates the impact of UI on the composition of unemployment; it cannot be used to estimate the increase in the unemployment rate. The extent to which UI increases the rate of unemployment can only be answered by measuring the extent to which the duration of the vacancies open to UI recipients increases as a result of UI. Although no precise figures are available, the job vacancy data for manufacturing indicate that job vacancies do not go begging as the unemployment rate increases. The vacancy rate in manufacturing was 1.3 percent in 1969 and .5 percent in 1971; long-term vacancies lasting more than thirty days decreased from .6 percent to .1 percent during this period. The manufacturing accession rate (total number of hires as a percent of total employment) indicates that job vacancies are quickly filled since accessions, which include recalls, are much greater than vacancies, and the accession rate falls much less during recessionary periods than do vacancy rates. The manufacturing accession rate was 4.7 percent in 1969, 3.9 percent in 1971, and 3.7 percent in 1975.[19]

Although the data support the proposition that the UI program is operating efficiently by keeping experienced workers in place during

a recession (which increases their unemployment duration) while allowing inexperienced workers an increased chance to fill available vacancies (which decreases their unemployment duration), the problem remains that the existence of the UI system encourages a planned withdrawal from the labor force to be artificially delayed if the person can collect UI, along with the problem of some workers not searching for or accepting suitable jobs while they collect UI (and "vacation"). But the program does not operate in an institutional vacuum, and recipients cannot unilaterally decide whether and when they will collect benefits. All workers are required to fulfill "work requirements"--being able and available for work, searching for work, and accepting a suitable job if offered. How well these rules are enforced is a matter of vigorous debate. In order to see how well these rules are working, I examined the nonmonetary determinations (i.e., the rulings that pertain to all aspects of the UI system other than the initial determination of eligibility based upon the person's base earnings) for California over the 1969 through 1975 period (see Table 7). In the three years shown, over one in six persons applying for UI were denied benefits because they did not fulfill at least one nonwage requirement. Although we have no idea what the true disqualification rate should be, such a high rate indicates that the UI program does not act as a general income support program for any worker who cares to sign up. Characterizations of the UI program as a system in which workers decide between reporting to their job or taking a paid vacation on UI are clearly an exaggeration.

Table 7

Disqualification Rulings in California

Nonmonetary disqualifications as a % of initial UI claims:	1969	1971	1975
TOTAL	16.8%	17.6%	17.6%
For voluntary quitting	5.4	5.1	4.9
For misconduct discharge	1.9	2.1	2.0
For not available to work	4.8	5.6	6.3
For failure to seek work or refusal of suitable work	1.2	1.1	1.0
Distribution of disqualifications:			
TOTAL	100.0%	100.0%	100.0%
For voluntary quitting	32	29	28
For misconduct discharge	11	12	11
For not available to work	29	32	36
For failure to seek work or refusal of suitable work	7	6	5
For other reasons	21	21	20
Percent of determinations that are disqualified (disqualification rate):			
TOTAL	42.0%	43.0%	44.0%
For voluntary quitting	63	66	67
For misconduct discharge	24	24	24
For not available to work	46	44	51
For failure to seek work or refusal of suitable work	24	28	30
For other reasons	46	46	40

Source: Annual averages calculated from State of California, Employment Development Department, Report 525 and Operations Report, various issues.

The most important reasons for disqualification are findings of voluntary quitting or not available for work. During the full employment year of 1969, almost one third of the disqualifications were for voluntarily quitting one's job; another 30 percent were for the person's not being available or able to work. The former group declines in importance and the latter group increases in importance during the recessionary periods, so that they represented 28 and 36 percent, respectively, of all disqualifications in 1975.

The frequently heard charge that people can easily take advantage of the UI program by not fulfilling the work rule during recessionary periods when large numbers of workers are thrown out of work is not supported by the California data. If we compare the high unemployment period of 1975 to the low unemployment period of 1969, we find that the proportion of claimants who are disqualified rises slightly and that the disqualification rate also increases. The disqualification rate for cases dealing with voluntary quitting, not being available for work, or failing to seek work (or refusing a suitable job) increases by 6 to 25 percent. Of course, these disqualification figures do not mean that everyone who collects UI benefits is obeying all the rules, but they do indicate the absence of wide-spread cheating during a major recession. In addition, any situation of wide-spread cheating must be accompanied by a large number of vacancies that remain unfilled while UI recipients remain at home. But during recessionary periods, this is clearly not the case.

In a full-employment period, the best work test that can be applied is the offer of a suitable job, and this depends upon the proper

functioning of the State Employment Service in conjunction with the Unemployment Insurance Office. Although this is the best mechanism for applying the work test during a period of full employment, only 1.2 percent of all claimants were disqualified in California during 1969 for failure to seek work or for refusal of suitable work. Whether the low rate indicates that recipients willingly accepted suitable jobs or whether it indicates that recipients were not often referred to suitable jobs is unknown. But during a full-employment period, seasonal (as opposed to cyclical) unemployment becomes a primary cause of unemployment, and work rules are not the appropriate mechanism to deal with the seasonally unemployed worker. In 1969, 60 percent of the UI claims represent initial claims for different individuals, while 40 percent represent one or more additional claims by persons during a benefit year.[20] These repeat claimants include workers in seasonal industries and workers in casual and temporary jobs. Although the work rules can be used to ensure that these people accept work when it is available, this would not decrease the number of claims even though it might reduce their duration.

III. Policy Recommendations

An unemployment insurance program should be flexible in its response to variations in economic conditions. For example, during full employment the program should operate more as an insurance system, and during recessionary periods the program should take on the characteristics of a more general income support program. This research has shown that the UI system performs primarily as intended--as a program for experienced workers who lose their jobs. During the severe recession of 1974-75 and the stagflation that followed, the unemployment insurance system experienced numerous changes as Congress tried to patch the system to compensate for shortcomings as they appeared. All of the extended benefit programs, both the permanent and the temporary extensions and Supplemental Unemployment Assistance (SUA), were based upon the state programs. The Federal government spent more than 3 billion dollars for the temporary and permanent extensions of UI in 1975 in addition to outlays on SUA. These extensions eased the plight of the worker who otherwise would have exhausted his or her UI benefits and covered the worker whose previous work experience was in uncovered employment. The new or recent entrant remained uncovered by these extensions.

The impact of Federal extensions upon the unemployed recipient depends upon the state in which the worker resides. The determination of eligibility and benefit amounts depends upon state law so that these extensions have heavily favored workers who are in states with liberal UI programs. Although the current extensions of the UI system were easy to implement, they cannot be considered to be a replacement for a general income support program even on a temporary basis. In general, the variations across the states in benefits, duration, and eligibility, and the

lack of coverage for entrants cause problems in using UI as an income support system. For certain classes of unemployed workers there are inadequate benefits in some states and no benefits in others. Furthermore, using UI as a general income support system is expensive because this program funnels money to the unemployed on the basis of earnings. A general income support program should target money to those most in need rather than use an existing program which does not take need into account in determining eligibility or benefit payments. These UI extensions may be politically expedient, but they are not adequate in a recessionary period as a replacement for a general income support program.

But in the absence of a general income support program, we should not recommend changing the UI program in ways that would cut out workers who have no other means of acquiring income during a period of unemployment. A complete overhaul of the UI system must await the introduction of a more general income support program. In the meantime, a piecemeal approach is possible: Keep the present system but legislate Federal standards, especially for eligibility and benefit levels. During recessionary periods, the federal government could add another means-tested program that covered people who were normally ineligible for UI. An example of this kind of program is AFDC-U, which currently operates in fewer than half of the states. This type of approach, which would make UI more of an income support program, would be easy to implement in theory; but the task of coordinating the myriad of state programs under one umbrella would be difficult. A more basic reform would be to institute a general income support system and maintain UI as a wage insurance

system for the experienced unemployed worker. With the general income support system available to everyone on a means-test, we would do away with the problem of targeting money to people with need; and the problem of coverage would no longer be a criteria by which to judge UI. In this situation, UI would become more of an insurance system. Accordingly, we could tax UI benefits and do away with the extended benefits and dependence allowances, and instead strengthen the connection between benefits, contributions, and past wages. But this last situation is closer to an economist's dream world than political reality.

Two major concerns during periods of full employment are the seasonal worker and the speed with which workers return to suitable jobs. The emphasis of the present program on the worker who cannot find employment year-round as a result of industry attachment must be examined because of the high cost to the system and the direct subsidy UI provides to these industries. This result must be evaluated by asking if this subsidy to seasonal industries is justified on noneconomic grounds and if the benefit distribution reflects social goals of the program.

The other concern--providing incentives to the worker to return to work--can be examined by asking if the administrative rules are functioning properly. In order to insure that people do not misuse the system, we can either rely upon the administrative rules (e.g., the eligibility and seek-work rules) to police the system, or we can use the "whip of hunger" approach of low benefit levels to force people back to work. With these choices, the administrative rules may be seen as a small cost to bear in order to have adequate benefit levels. The data from California indicate that the work rules do behave over the

cycle as expected, and that the Unemployment Insurance system is currently policed fairly well. During the past eight years of fairly high unemployment, Unemployment Insurance has unfortunately obtained a scarred reputation in the eyes of the public. Widespread publicity about the golf pro who vacations in Florida, the housewife who wallpapers her house, or the young man who travels the country visiting freinds--all collecting UI benefits--have painted a public image of the UI recipient being someone who is vacationing on the public dole while refusing suitable jobs if they are offered or not bothering to look for work. Ironically, it is during those periods when UI is depended upon by a large number of people to provide them with basic income that the program gains public resentment because of its increased cost. As a result of the bad reputation of UI with the public, fair administration of the work rules has become even more important. The UI administrators, businessmen, and trade unions must police the system if they do not want implementation of the alternative approach of low benefit levels to decrease misuse of the system.

During periods when the number of job seekers greatly outnumbers the available job slots, the Unemployment Insurance system may primarily affect the composition of the unemployed, rather than the level of unemployment. This outcome will result if UI recipients search longer for the next job (or wait for recall), so that the available vacancies are taken by new or recent entrants or others not eligible for unemployment benefits. The increased job search of UI recipients will increase the unemployment rate only to the extent that it increases the actual duration of vacancies. Although this impact may be important during full employ-

ment periods, during recessionary periods the increased job search time of UI recipients does not seem to increase the duration of vacancies. Though the answer is not precisely measured, the data indicate that the presence of UI extends the duration of unemployment for experienced workers and decreases the duration of unemployment for inexperienced workers. In this way the UI program is actually operating efficiently. Although the UI system does not give monetary aid directly to uncovered workers, it does aid them through allowing them greater access to vacancies that do not require work experience.

This research also addressed the question, "What are adequate benefits?" The answer cannot rely solely upon the replacement rate of unemployment benefits compared to take-home wages. But rather, this replacement rate must be compared to the short-run nondeferrable expenditures of the family. This research showed that middle and lower-middle income families need a replacement rate above the current fifty percent rate in order to cover nondeferrable expenses if the family has only one earner. In addition, middle, and upper income families need increased maximum benefit rates if they want to cover their nondeferrable expenditures when they have only one earner. In those families with both the husband and wife employed, a fifty percent replacement rate will allow the family to cover its nondeferrable expenditures if the wife is unemployed. But the average lower-middle income family will not be able to cover its nondeferrable expenditures when the husband is unemployed if his wage replacement rate is below sixty percent. In the middle and upper income families, the maximum benefit ceiling is too low when the husband is unemployed for the family to be able to cover its nondeferrable expend-

itures. In general, this research shows that a fifty percent replacement rate is too low for lower-middle income families and that the maximum benefit ceiling is too low for moderate and upper income families in the current UI system. As a consequence, the only spells of UI covered unemployment that do not inflict financial hardship are those of wives or teenaged children in families where an employed male adult is present.

A benefit structure that provides adequate benefits for unemployed workers should be constructed so that: (1) the replacement rate declines as income rises, and (2) adjustments are made for the presence of other earners. Possible approaches include the following:

1. Make the wage replacement rate regressive (i.e., the replacement rate decreases as the wage rate increases), and have dependents allowances. For example, the replacement rate may start at 80 percent on the first dollar of earnings and decline to 20 percent as a maximum benefit ceiling is reached. The addition of dependents allowances when the family has no other workers would help adjust benefits to family needs.

2. Make the wage replacement rate regressive and tax benefits. This second case is similar to the first except that the taxation of UI benefits replaces dependents allowances for one-earner families as a mechanism for adjusting benefits to family needs. Although the taxation approach is preferred to the dependents allowances on economic grounds, it may not be politically feasible.

3. Make the replacement rate regressive, have dependents allowances for all recipients and tax benefits for units with incomes above a certain amount. This case is a combination of (1) and (2) above in that it directly adds on dependents allowances in determining the basic

benefit and brings in taxation for high income families. This complicated example is a sample of the possibilities that can be explored in devising a program that fulfills the two economic criteria as well as unstated political objectives. But in all cases, higher benefit ceilings are needed, and replacement rates that decline as wages increase are needed in order to match a family's benefits with its nondeferrable expenditures.

The seasonality bias is an important issue during a full employment period. But during a recessionary period, seasonal unemployment is not distinct from cyclical unemployment since many of the industries that have definite seasons also suffer the most under a cyclical downturn. This report has shown how benefits based upon high quarter earnings are biased towards seasonal workers. One alternative approach would be to pay benefits based upon a worker's high quarter earnings up to a designated maximum of the worker's average annual earnings, for example, in benefit calculations the high quarter earnings could not exceed 40 percent of average annual earnings. In this way, a compromise would be struck between calculating benefits from high quarter earnings or from average annual wages. This report has emphasized that the seasonality bias is better attacked through shifting the benefit structure from being solely dependent upon high quarter earnings to being related also to annual earnings rather than the alternative approach of completely experience-rating the financing system for UI. The argument was based upon two observations: cyclical downturns have a random variable that should not be reflected in the long-run wage structure, and recessions incorporate a social good (reducing inflation). Although some form of

experience-rated financing as we now have is beneficial because it keeps firms involved in the monitoring process, a pure experience rated system would create a major problem in timing taxation and would place a disproportionate burden upon those firms that shoulder the major part of a cyclical downturn. Because cyclical downturns are induced by the government to stop inflation, Federal financing from general revenues perhaps is the best way to finance Unemployment Insurance for unemployment above some designated frictional amount. This would amount to experience-rating the Federal government and would result in payments to those workers who bear the unemployment in order for society to enjoy more stable prices. In addition, experience-rating the Federal government would force it to bear the costs of its own deflationary policies.

In summary, this study indicates that the UI system has been functioning fairly well as an insurance system for the experienced worker and that the UI system seems to have operated fairly well during a period of recession and stagflation. Any discussions about the current program must include recognition of the conflicts inherent in trying to have one program that provides both wage insurance and general income support. Contrary to widespread public belief, this research has shown that most workers who are collecting Unemployment Insurance while suffering a spell of unemployment are not living high on the hog. In contrast, the study indicates that most families with an unemployed worker are suffering financial strain in addition to the other strains that accompany unemployment. And in addition, this research has attacked the proposition that the UI system increases the unemployment rate. Instead, during recessionary periods, the UI system may shift the burden of unemployment

from those inexperienced workers to those experienced workers who are kept in place until they can return to their old jobs, or jobs that reflect their skills. In summary, this research has indicated that the UI system is performing much better than the average economist or lay-person seems to believe. This cynicism may reflect the fact that, as a society, we are having a difficult time bringing down the unemployment rate. In such a situation, perhaps it is easier to engage in wishful thinking ("Unemployment is not as bad as we thought it was.") Unfortunately, the unemployed worker has become the scapegoat as the current thinking on UI has implicitly made the unemployed person responsible for his or her unemployment. But most of the economic criticisms leveled at the UI system can only be legitimately made during a full employment period; these criticisms of the seasonality bias and of the impact of UI on the unemployment rate cannot be leveled against the UI system during the current recessionary period. Instead, the UI system has weathered the poor economic performance of the 1970's fairly well and has been the most important income support system for the experienced worker during the past four years.

FOOTNOTES

1. Daniel Nelson, Unemployment Insurance; the American Experience, 1915-1935, The University of Wisconsin Press, 1969; Arthur J. Altmeyer, The Formative Years of Social Security, The University of Wisconsin Press, 1968; Edwin E. Witte, Social Security Perspective, (edited by Robert J. Lampman), The University of Wisconsin Press, 1962.

2. Richard A. Lester, The Economics of Unemployment Compensation, Princeton, 1962, and William Haber and Wilbur J. Cohen, Unemployment Insurance in the American Economy, Irwin, 1966. In addition, the W. E. Upjohn Institute for Employment Research in Kalamazoo, Michigan has published numerous volumes on the UI system since the early 1960's. These include: Joseph M. Becker, The Adequacy of the Benefit Amount in Unemployment Insurance, 1961; Leonard P. Adams, Public Attitudes Toward Unemployment Insurance: A Historical Account with Special Reference to Alleged Abuses, 1971; Merrill G. Murray, The Treatment of Seasonal Unemployment Under Unemployment Insurance, 1972; George S. Roche, Entitlement to Unemployment Insurance Benefits, 1973; and Raymond Munts and Irwin Garfinkel, The Work Disincentive Effects of Unemployment Insurance, 1974.

3. Concern with UI's adverse impact on the efficient operating of the labor market gained national recognition with Martin Feldstein's Lowering the Permanent Rate of Unemployment, A Study Prepared for the Use of the Joint Economic Committee, 93 Congress, 1 Session (1973).

   A recent volume of the Industrial and Labor Relations Review (Vol. 30, No. 4, July 1977) was devoted to ten papers from a symposium on UI. These papers represent the current range of neoclassical analysis on UI. See also Ronald G. Ehrenberg and Ronald L. Oaxaca, "The Economic Effects of Unemployment Insurance Benefits on Unemployed Workers' Job Search," Final Report Submitted to ASPER, U.S. Department of Labor under Contract L74-49, June 25, 1976 (summarized in the "Unemployment Insurance, Duration of Unemployment, and Subsequent Wage Gain," American Economic Review, Vol. 66, No. 5. (Dec. 1976); Gary S. Fields, "The Direct Labor Market Effects of the U.S. Unemployment Insurance Ssytem: A Review of Recent Evidence," Industrial Relations, February 1977; and Stephen T. Marston, "The Impact of Unemployment Insurance on Job Search," Brookings Papers on Economic Activity, Vol. 1, 1975.

4. The moderate budget represents the median wage earned, which is slightly below the median income of the household.

5. A discussion of the survey can be found in "The 1972-73 Consumer Expenditure Survey," Monthly Labor Review, December 1974. The results presented in this paper are from tabulations made on the 1972 data in the initial tapes made publicly available; the sample used in this paper includes 3990 husband-wife families with the husband aged 26 to 65 years old and with an annual income between

$6,000 and $35,000.

6. If the lower-middle income families had an earnings replacement rate of 64 percent to cover weekly nondeferrable expenses of $110 on the average, they would also be constrained by the benefit ceiling, since only two states (Connecticut and Massachusetts) provided 1972 benefits above $110. State UI laws are summarized in Unemployment Insurance Service, "Significant Provisions of State Unemployment Insurance Laws, July 2, 1972," U.S. Department of Labor.

7a. U.S. Department of Commerce, Bureau of the Census, Current Population Reports, Series P-60, No. 90.

7b. The wife's UI benefits (50% of her normal wage, which is 30% of the family's income) provide 15% of the family's normal income, leaving 50% of normal income that must be provided by the husband's net earnings in order to cover nondeferrable expenditures. This is the situation as long as the husband's average tax rate does not exceed 30%.

7c. The husband's UI benefits (with a 50% replacement rate) provides 35% of the family's normal income. The wife's gross earnings equal 30% of the family's normal income, which is needed for the family to have 65% of normal income for nondeferrable items.

7d. If the wife's average tax rate is 12%, than the husband's UI benefits must provide 41 percent of the family's normal income, which requires a 59% replacement rate on his earnings.

7e. The husband's UI benefit with a 50% replacement rate equals 38 percent of the family's normal income, so the wife's earnings need to equal 16 percent of the family's normal income in order to cover the nondeferrable expenses. Sincer her gross earnings average 25 percent of the family's income, the above condition will be met as long as the average tax rate on her earnings does not exceed $\left(1 - \frac{16}{25}\right) \cdot 100 = 36\%$.

8. This assumes that average payroll and income taxes on the wife's earnings are only 15 percent.

9. Unemployment Insurance Service, U.S. Department of Labor, "Significant Provisions of State Unemployment Insurance Laws, July 2, 1972."

10. Again, payroll and income taxes are assumed to average 15 percent of the wife's earnings.

11. Unemployment Insurance Service, "Significant Provisions of State Unemployment Insurance Laws, July 2, 1972."

12. All industry benefits and contribution figures are Employment Development Department, State of California, Report 352, 1965-74 average, dated February 24, 1976.

13. Calculated from California's Form ES-206 for 1973, reported to the Unemployment Insurance Service, U.S. Department of Labor, Washington, D.C.

14. Charles Sevick, Gene Inman, and Frederick Nichols, "Seasonal Patterns of Compensated Unemployment in California, 1967, 1968, and 1969," Employment Development Department, State of California, May 1972.

15. Charles Sevick, Gene Inman, and Frederick Nichols, "Characteristic Study of Unemployment Insurance Claimants Who Filed Claims in 1970," Employment Data and Research Division, Employment Development Department, State of California, December 1974, p. 9.

16. Martin Feldstein, "Unemployment Compensation: Adverse Incentives and Distributional Anomalies," National Tax Journal, Vol. 37, (June 1974); Joseph M. Becker, Experience Rating in Unemployment Insurance: Virtue or Vice, Upjohn Institute, 1972.

17. The relationship between the turnover or job search behavior of workers, the duration of vacancies, and the unemployment rate is developed in Clair Vickery "The Impact of Turnover on Group Unemployment Rates," The Review of Economics and Statistics, Vol. LIX, No. 4, November 1977.

18. For a discussion of recent government-collected vacancy data, see Paul Armknecht, Jr. "Job Vacancies in Manufacturing, 1969-73," Monthly Labor Review, August 1974. For a discussion of vacancy data in general and of the Help Wanted Index in particular, see Vickery, Why Unemployment Rates Differ by Race and Sex, Ph.D. dissertation, University of Maryland, 1973.

19. The vacancy and accession data for manufacturing is reported monthly in Bureau of Labor Statistics, U.S. Department of Labor, Employment and Earnings.

20. The percentages of initial claims that are from new and repeat claimants were calculated from Employment Development Department, State of California, Operations Report, issued monthly.