

Challenges in Today's Unemployment Insurance System

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After a year of crippling economic impacts due to the coronavirus pandemic, at least 16 million workers remain unemployed. [The national unemployment rate](#) for February 2021 was 6.2 percent; in February 2020, it stood at 3.5 percent.* Many unemployed workers have struggled to make ends meet over the past year. Since March 2020, the unemployment insurance system was changed to help workers make ends meet during the pandemic. These measures created challenges for state unemployment insurance administrators and have often fallen short of the program's goals.

Unemployment insurance (UI) is a form of social insurance that was created in 1935 during the recovery from the Great Depression. The UI program has two major goals. The first is to provide an income-smoothing effect for workers and their families during times of joblessness. The second focuses on the macroeconomic priority of stabilizing consumer spending during economic downturns. Both goals are equally important, as they enable workers to keep paying bills and caring for their families, which, in turn, keeps other workers employed because demand does not fall as sharply.

The UI system in the United States is, at its core, a flexible program. States receive limited guidance from the federal government, so while their programs can be similar, workers in different states will have different experiences and receive different benefits. Between legislation in the [Social Security Act of 1935](#) and the [Federal Unemployment Tax Act of 1939](#), states are required to use their UI funds solely for the purpose of paying unemployment insurance to workers, and states cannot excessively burden workers when they are applying for benefits. Although states hold most of the power to determine the benefit length and amount, the federal government provides administrative costs and contributes to specialty unemployment benefits, such as Extended Benefits.

Challenges to the UI system

Over time, however, unemployment benefits have fallen short of reaching either of the program's original goals. Among the problems are a declining wage replacement ratio, a smaller share of unemployed workers receiving benefits at all because of state barriers to access to the UI system, and more difficult eligibility criteria.

Although jobless benefits in the United States were never intended to provide full-wage replacement (100 percent of lost wages), the vision was to provide enough to pay nondeferrable bills and maintain some level of spending. Historically, this ratio hovered around 50 percent nationally but has been declining, according to data from the [Employment and Training Administration](#). On a state level, the "declines have been much sharper in low-benefit states," according to researchers [Stephen A. Wandner and Christopher T. King](#). For instance, in North Carolina, replacement rates fell from above 50 percent in

2013 to 31.7 percent in the third quarter of 2020. [Wandner and King](#) suggest that the decline in low-benefit states reflects employer unwillingness to pay for the insurance program.

In addition to the decline in wage replacement rates, the number of unemployed workers who are receiving benefits has also been falling. It should be noted that this measure is cyclical; during times of economic recession, this percentage increases, which was the case in 2020. However, since there have been no structural changes to the unemployment system throughout the pandemic, the reciprocity rate is expected to return to its negative trend during the recovery. When Franklin D. Roosevelt signed the Social Security Act into law in 1935, eligibility requirements were much more generous, [though still unequal](#). Today's unemployment system does not cover groups of workers who left their job (quit) or were terminated with cause (fired), which was originally included. [In 1945, 26 states limited coverage of these groups](#). Since the 1980s, just over 30 percent of workers receive benefits nationally, with most states serving less than 25 percent of unemployed workers.

The pandemic has brought about new challenges to the UI system and exposed sections of the law that are outdated. The first of these challenges is who unemployment covers. The Social Security Act of 1935 excluded agricultural and domestic workers, and while some changes have been made to remedy that exclusion, unemployment insurance often excludes [communities of color more than white workers](#). Over time, states have purposely decreased the groups of workers that are eligible for unemployment benefits, and changes in the labor market have also pushed this number lower. Specifically, gig workers and contractors were not considered for jobless benefits regardless of their work history.

As the use of technology has increased, more workers are participating in the gig economy. The U.S. Bureau of Labor Statistics has been recording data on this group of workers through the Contingent Worker Supplement survey. For this survey, someone is considered a gig worker if they participate in temp agency work, on-call work, contracted work, or freelancing. According to [research by MBO Partners](#), the percentage of workers who are choosing independent/gig work is increasing. In a 2020 survey, MBO Partners found that 10 percent of workers were looking to move to the gig economy and 6 percent more were considering it. Data from the Atlanta Fed's [Unemployment Claims Monitor](#) show that at least 45 percent of unemployment claims at the beginning of March 2021 were submitted by workers in this category (that is, they were collecting Pandemic Unemployment Assistance).

Reliance on congressional approval for emergency unemployment programs during economic downturns can prevent workers from receiving the benefits they need. Debate surrounding the multiple bills related to unemployment demonstrates this problem. On March 27, 2020, Congress passed the CARES Act, which increased unemployment benefits by \$600 a week. The program garnered both praise and criticism. The \$600 payment created by the CARES Act expired at the end of July 2020. In August, President Trump signed an executive order to extend the benefits through the end of 2020 at the reduced rate of \$300 in additional benefits per week. As the program approached its second expiration date, Congress struggled to come to an agreement that would extend the program for three more months, despite warnings from public health experts that the coronavirus would outlast that extension. The [American Rescue Plan Act of 2021](#) narrowly passed the House and Senate before the expiration of benefits, creating unnecessary stress and uncertainty among the unemployed when there are still not enough jobs to employ these workers.

Previous attempts to reform the federal unemployment system

After unemployment insurance was created in 1935, the economy had years of sustained job growth and low unemployment. Until the 1970s, the UI system was working well. However, since the 1973–75 recession, unemployment insurance has covered fewer workers with lower benefits and struggled to pay for those programs during downturns. Realizing the program was not meeting its goals, Congress

created the National Commission on Unemployment Compensation to determine recommendations for reform. After the commission released its [report](#) in 1980, none of the measures were implemented. During the recession of the early 1990s, Congress created the Advisory Council on Unemployment Compensation as part of the Emergency Unemployment Compensation Act of 1991; similarly, when [its report](#) was released in 1996, Congress made no changes to the federal unemployment legislation.

During the Great Recession, President Obama took a different approach by offering incentives to states that would update their UI systems. The 2009 Recovery and Reinvestment Act appropriated \$7 billion for UI modernization, [which prompted 39 states to make reforms over three years](#). In order to receive funds, states had to pass or amend their UI legislation, modify regulations to include more workers, or clarify current processes.

Currently, UI operates through joint federal-state programming, with both entities levying taxes and participating in the distribution of funds. Previous reforms have focused on enhancing this structure without creating uniformity at the federal level. Current policy reform recommendations include creating a single set of federal guidelines for benefits and funding (payroll taxes), but still relying on state labor departments to administer and distribute benefits. Different still, a national UI program would hold the federal government responsible for setting all provisions and administering benefits.

Recommendations to modernize the UI system

An improved UI system could include three major features. The first two would address the original goals of the unemployment system, while the last would improve labor market functionality for lasting economic results. Wandner and King suggest standardizing benefit amounts, duration, and access across states to minimize administrative costs and improve national equity, redesigning the tax system to be progressive and eliminate competition between states, and constructing reemployment services to get workers into good jobs quickly. A national UI program would most effectively meet these goals.

Access to unemployment insurance is a key factor to the success of the program. Due to changes in the labor market, state unemployment legislation, and hard-to-use application portals, fewer and fewer unemployed workers can access their benefits. A consistent federal application would remove confusion for workers who have lived in multiple states or for workers seeking guidance through the online community. A modernized UI program would acknowledge that the nature of work is changing and address the social insurance needs of gig workers, part-time workers, short-tenured workers, and other less traditional work arrangements that are increasingly common. A good target for unemployment coverage is at least 50 percent across all states, though this ratio would still vary based on cyclical effects.

Even with improved access to unemployment benefits, the benefit amounts are widely variable. In some states, benefits are so low they do not meet the goals of stabilizing household finances or creating consistent buying patterns. As with all government programs, equity is an important factor to consider. [Reforms surrounding benefit amounts could be capped at 67 percent of the state or national wage and provide a 50 percent replacement rate](#). Extended benefits programs that are triggered by recessions could be continued and expanded to limit the amount of short-term policy needed to stabilize the economy.

Currently, the federal government levies a 6 percent tax on the first \$7,000 of every employee's salary to cover UI costs. However, states set their own individual payroll taxes and if companies meet state requirements, the federal rate is reduced to 0.6 percent. The tax is paid quarterly, and funds are held by

the U.S. Treasury Department for each state. Unfortunately, states often underfund their UI trust funds in order to have competitive business taxes and attract more companies. In fact, the [State Unemployment Insurance Trust Fund Solvency Report 2020](#) reported that 22 states held funds below the recommended amount. With that funds shortfall, a [recession would create additional stress, which could lead to states reducing benefit amounts when workers most need it](#).

A federally levied tax would reduce the need for states to undercut the UI trusts to gain new employers. This system would also allow a larger pool of funding for states that often experience different economic conditions. Work by [Michael Miller and Robert Pavosevich](#) provided evidence that the current method used to determine the tax rate that employers pay in UI taxes (the experience rating system) is inefficient and could be improved or eliminated. Although the current system relies on different agencies to collect taxes, a national system could consolidate through the Social Security Administration (SSA). Using the SSA would help with collection, since the agency already collects payroll taxes from businesses and income taxes from employees.

A national UI program would also shorten the timing between emergency provisions that often occur during recessions and the administration of those enhancements. As was the case in the COVID-19 recession, emergency provisions—including the addition of gig workers via Pandemic Unemployment Assistance and supplemental payments—took weeks to implement. In fact, a month after the CARES Act was passed, [only 21 states had begun paying Pandemic Unemployment Assistance to self-employed or gig workers](#). The two main reasons for the delay were a lack of guidance from the U.S. Department of Labor and the challenge to incorporate those changes into antiquated UI processing systems. A national UI would create one processing system, down from 53 (the 50 states plus the District of Columbia, Puerto Rico, and the Virgin Islands), and limit the communication needed when clarifying new policies.

Finally, unemployment policy reform could consider how the program can enhance worker stability and reduce the frequency of workers applying for unemployment insurance at all. To do this, reemployment services need increased funding. The new funds can help workers find training programs that connect them to good jobs and boost the number of staff who are available to help with that search. By creating a strong reemployment service, a swift and long-term return to work paths could be achieved.

Immediate actions

In its current form, the U.S. system for unemployment insurance is not efficient. It does not meet its goals of stabilizing the economy through consumption smoothing and of helping unemployed workers pay their expenses while they are out of work. Taking action to secure a strong unemployment system through these proposals represents a fundamental rethinking of our UI system and its mechanics. The reforms would involve complex changes, but they represent a path toward better serving workers both in times of economic recession as well as in the increasingly volatile and changing labor market. Overhauling the outdated federal-state UI program into a cohesive national system will require new administrative strategies, involve several federal agencies, and require time for thoughtful implementation.

Author's note: Much of this article is informed by [work published through the Better Employment and Training Taskforce by Stephen Wandner and Christopher King](#). The authors detail the necessary mechanics and process to implement each of these recommendations. Wandner is leading the National Unemployment Insurance Task Force convened by the National Academy of Social Insurance, which will be proposing options for UI reform later this year.

*The link will update to the newest BLS report, which is released every Thursday at 8:30 a.m. (ET).

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