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Why State Unemployment Insurance is Broken – Can We Fix It?

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When Americans are laid off from their jobs, they are supposed to receive unemployment insurance benefits – paid from state trust funds built up in good economic times. Cash benefits are meant to be available for up to 26 weeks to help families buy food and cover such costs as rent, utilities fees, and payments for car repairs and insurance. Unemployed men and women who get such help also spend money that keeps the economy going for everyone in their states and communities.

But over the past four decades, the percentage of U.S. unemployed workers who qualify for and receive state unemployment benefits has declined. At one time, nearly half the unemployed got help, but that has declined in some recent years to less than three of every ten unemployed. In sharp economic downturns, Congress sometimes votes to send extra funds to long-term unemployed people, especially in hard-strapped states. But partisan deadlock can block action. Relying on Congressional action adds to the uncertainty the jobless already face, and may give inadequate economic help to the regions of the country that need it most.

Why has U.S. unemployment insurance broken down, and how can we remedy the situation?

How States Make it Harder for the Jobless to Collect Benefits

Three factors determine whether a person is allowed to collect unemployment insurance benefits: (1) having regularly worked for wages in the past; (2) losing a job without fault; (3) and actively looking for new work. Within these overall rules, however, the 1935 Social Security Act that set up our current system gives each state a lot of freedom to define what counts as regular work for wages, to assign blame for job loss, and to specify the efforts that count as an adequate search for new work. Southern and southwestern states have more restricted eligibility – and when state governments face fiscal crises, they often tighten the rules.

The Big Picture of Benefit Decline

Shifts in the U.S. economy have gone hand in hand with efforts by state governments to reduce the proportion of workers who are eligible and shrink the value of unemployment benefits.

- Millions of Americans have moved from the North and Midwest into the South and Southwest – so many workers who would have been covered by unemployment insurance in their original regions are no longer covered in states with more restrictive rules.

- As the U.S. economy shifts from manufacturing to service-sector employment, lower percentages of workers are eligible. Service-sector workers often do not have unions to bargain for them. Their jobs involve more layoffs and sometimes provide only part-time work, which makes it harder for those laid off to fit into restrictive definitions of having a steady prior work history. Ironically, as work becomes more tenuous, people laid off lose eligibility for unemployment benefits because they were not in the "right" kinds of jobs.

- Since the start of U.S. unemployment insurance, employers have become increasingly wary – because taxes on employers who lay off a lot of workers are used to build up state trust funds. In recent times, employers have gone so far as to hire specialized firms to contest claims filed by their former employees. This, in turn, leads to lower fund balances in state trust funds – and reductions in benefits for qualified laid off workers. In a self-reinforcing spiral, states have more and more reasons to tighten eligibility and cut the value of benefits.

- The value of unemployment insurance benefits is also reduced when benefits are taxed. Reductions are greatest in states that rely on income taxes and use income reported for federal taxes to determine state tax liability. Taxation of jobless benefits started in 1979 just for higher-income earners, but by 1986, all unemployment benefits became fully taxable. This burdens families and households that are already suffering from layoffs.

How the Federal and State Governments Can Repair Unemployment Insurance

As state benefits shrink, the federal government has tried to fill the gap by financing extended benefits during recessions, when workers often exhaust 26 weeks of eligibility. But Congress can act slowly, become deadlocked, and spread money across the whole country, when some regions or states need extra help. Temporary federal actions also fail to address the long-term decline in eligibility or the eroding value of benefits.

Several types of reforms could help fix our rickety unemployment insurance system:

- Gear federal contributions to rise *automatically* with the unemployment rate – and send extra help to the hardest hit states and regions. This would reduce uncertainty for families and businesses, take partisan politics out of the picture, and give the economy a boost.

- State governments need to improve funding for jobless benefits by adopting new rules to ensure that all employers and employees regularly contribute enough taxes to build up trust funds during relatively good economic times.

- Improved funding will allow states to expand – rather than narrow – the range of jobs covered by unemployment insurance. Jobs in the United States are no longer as stable as they were when manufacturing reigned supreme, and the rules governing workers who can get help during layoffs need to adapt to the new kinds of jobs offered by service industries.

- Eliminate the taxation of unemployment benefits (or raise the benefits enough to offset reductions due to taxation). Research shows that taxation of benefits discourages many eligible workers from applying at all, and also dangerously reduces the help given to laid-off workers in economic distress. Taxation of unemployment benefits makes little sense, because it hurts both families and the economy when more buying power is needed most.

Helping laid-off workers and their families and boosting the national economy during downturns – these were the original goals for U.S. unemployment insurance. But America’s unemployment benefits no longer fulfill either goal, and we urgently need to take the steps necessary to get the system back on track.