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Unemployment-Related Benefits System in the United States

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EXECUTIVE SUMMARY

1. The United States (US) established a federal-state unemployment insurance system in 1935 through enacting the Social Security Act. The Social Security Act, by means of a tax credit, provided an inducement to the states and territories to enact unemployment insurance laws. By 1937, all states and territories implemented their unemployment insurance systems.

2. The federal government has stressed that the unemployment insurance system serves both primary and secondary objectives. The primary objectives are to provide financial help to workers during temporary periods of involuntary unemployment and provide time for the unemployed workers to find suitable jobs. The secondary objectives are to stabilize the economy and improve the utilization and allocation of labour resources.

3. The state unemployment insurance systems cover most private firms, state and local governments, and non-profit organizations. However, most states have not covered occupations such as self-employment, service for relatives, service of patients in hospitals, and certain seasonal camp-workers in the unemployment insurance systems. Approximately 123.5 million workers (86.7% of the labour force) were covered by state unemployment insurance systems at the end of 1998.

4. In the US, unemployment insurance benefits are available as a matter of right (i.e. without a means test) to unemployed workers who have demonstrated their attachment to the labour force by a specified amount of recent work and/or earnings in covered employment.

5. The amount of unemployment insurance benefits is about 50% of the worker's previous earnings. There are also minimum and maximum dollar limits. These arrangements are in line with relevant International Labour Organization (ILO) Conventions. The unemployment insurance benefits are taxable.

6. There is a maximum duration of 26 weeks of unemployment insurance benefits in a year. Unemployment insurance benefits are payable after a one-week waiting period. These arrangements are in line with relevant ILO Conventions. The federal and state governments provide an extended unemployment insurance benefits programme for workers who have exhausted their entitlement to regular state benefits during periods of high unemployment.

7. In the US, except in Alaska, New Jersey and Pennsylvania, state unemployment insurance programmes are financed by payroll taxes paid by employers on the employees' wages. States deposit the respective payroll taxes in their federal unemployment trust fund accounts and withdraw funds to cover the costs of state benefits and half of the extended unemployment insurance benefits.

8. The standard payroll tax rate in financing state unemployment insurance systems is 6.2%. However, the actual payroll tax paid depends on the employer's record of employment stability, measured by benefit cost attributable to former employees. All states use this system, called experience rating.

9. The federal functions of the unemployment insurance programme are chiefly the responsibility of the Employment and Training Administration in the Department of Labour. The Department of the Treasury collects payroll taxes, and the Treasury maintains the Unemployment Insurance Trust Fund. Each state administers its unemployment insurance law by maintaining records, collecting payroll taxes, determining eligibility, processing claims, and paying unemployment insurance benefits.

10. Unemployed persons who have exhausted their unemployment insurance benefits and are still unemployed may be eligible for public assistance programmes. It should be noted that there is no unemployment assistance programme in the US.

11. The federal and state governments operate a number of public assistance programmes such as Temporary Assistance For Needy Families, Food Stamp programme, Housing Benefits, General Assistance, and Earned Income Tax Credit to provide social welfare benefits for persons in need. To be eligible for these programmes, a person must have income and assets below some officially defined standard. The social welfare benefits are not taxable. The social welfare benefits are generally financed out of the general revenues of government.

UNEMPLOYMENT-RELATED BENEFITS SYSTEM IN THE UNITED STATES

PART 1 - INTRODUCTION

1. Background

1.1 In October 1999, the Panel on Manpower and the Panel on Welfare Services requested the Research and Library Services (RLS) Division of the Legislative Council (LegCo) Secretariat to conduct a study on unemployment-related benefits systems.

2. Objectives and Scope

2.1 The objectives of the study are:

- to examine the experience of Mainland China, Taiwan, Malaysia, Singapore, South Korea, the United Kingdom (UK), and the United States (US) in implementing their unemployment-related benefits systems; if any
- to outline the research findings of the Organization for Economic Co-operation and Development (OECD) and the Conventions and Recommendations of the International Labour Organization (ILO) in unemployment benefits systems; and
- to make an overall comparative analysis of the experience in the above places in implementing their unemployment-related benefits systems, and study current provisions in helping the unemployed in Hong Kong.

2.2 The scope of the research, as agreed by the Panels, covers

- historical development;
- main features and components;
- eligibility requirements;
- types of benefits and amounts;
- duration of payment of benefits;
- tax treatment of the benefits;
- source of funds for the benefits; and
- administration of the unemployment-related benefits systems.

2.3 In this report, we outline the experience of the US in the establishment and operation of the unemployment-related benefits system. The US was chosen because the country has a long history in implementing its unemployment-related benefits system. The US is a member country of the International Labour Organization (ILO) but has not ratified the three Conventions on unemployment benefits systems. The relevant ILO Conventions are (i) *Ensuring Benefit or Allowances to the Involuntarily Unemployed Convention, 1934, (No. 44)*; (ii) *Social Security (Minimum Standards) Convention, 1952, (No. 102)*; and (iii) *Employment Promotion and Protection (Unemployment) Convention, 1988, (No. 168).*

2.4 This report is part of the series of studies discussing unemployment-related benefits systems. There are 11 separate research reports (RP13/99-00 to RP23/99-00) on this subject.

2.5 In this research, "unemployment-related benefits" refer to unemployment benefits and related welfare benefits. Unemployment benefits comprise unemployment insurance and unemployment assistance. Unemployment benefits are available to the unemployed only. In other words, these benefits are not available to people who are not unemployed. The recipient must be currently unemployed, able to work, willing to work and looking for work. Where there are no unemployment benefits or where these benefits are exhausted, welfare benefits may be made available to provide subsistence for those in need. These related welfare benefits, as defined in the 1996 Organization for Economic Co-operation and Development study of *Benefit Systems and Work Incentives*, include family benefits, housing benefits, child-care benefits and social assistance. They are made available to all citizens subject to a means-test, and are not specifically targeted at the unemployed.

3. Methodology

3.1 The research involves a combination of information collection and analysis. In addition to materials available in the Legislative Council Library, reference materials were acquired and borrowed externally. The necessary information have also been obtained from the United States Department of Labour, the California Employment Development Department, and the New York State Department of Labour. This research report is based on the information obtained from these sources.

3.2 In this report, we use the exchange rate of US$1 = HK$7.745 to convert the US currency into Hong Kong dollar.[1] The Hong Kong dollar is linked to the US dollar; hence, the exchange rate between these two currencies has been stable.

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[1] Census and Statistics Department, *Hong Kong Monthly Digest of Statistics*, September 1999, p. 111.

PART 2 - HISTORICAL DEVELOPMENT OF UNEMPLOYMENT INSURANCE SYSTEM

4. Development of Unemployment Insurance System

4.1 The unemployment insurance system in the United States (US) was established through the Social Security Act of 1935.[2] It was established as a federal-state system, rather than one completely administered by the federal government because of the fear that a completely federal system would be unconstitutional. Also, because of disagreement concerning benefits, financing, and administration, it was believed that each state was best suited to develop its own unemployment insurance system, and that state administration was more feasible than federal administration.

4.2 The Social Security Act, by means of a tax credit, provided an inducement to the states to enact unemployment insurance laws. A uniform national tax was imposed on the payrolls of employers who employed eight or more workers for 20 or more weeks in a calendar year. Employers had to pay a payroll tax to a state with an unemployment insurance system. The state could retain 90% of the payroll tax which would be credited to an unemployment insurance trust fund administered by the federal Department of the Treasury. The remaining 10% of the payroll tax was paid to the federal government for administrative expenses incurred by both the federal government and state unemployment insurance systems.

4.3 Employers in states which had not established unemployment insurance systems therefore would not have a competitive advantage over those in other states because they would still have to pay the federal payroll tax. Furthermore, their employees would not be eligible for unemployment insurance benefits. As a result, states had a strong financial incentive to enact acceptable unemployment insurance laws, and by 1937, all states and territories had passed unemployment insurance laws. This Act is now applied to all 50 states, the District of Columbia, Puerto Rico, and US Virgin Islands. Except in three states (Alaska, New Jersey and Pennsylvania), employees are not required to finance the unemployment insurance system.

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2 Prior to the enactment of the Social Security Act, only limited assistance was available to unemployed workers. Some states had established work relief programmes, which provided some assistance to the poor; however, recipients were required to work or perform other public services in return for the aid. Private charities provided some assistance, but their limited financial resources precluded payment of unemployment benefits for extended periods. Some labour unions also provided temporary assistance, but to relatively few recipients. A few firms had established private unemployment plans, but financing problems and massive unemployment during the depression of the 1930s made it difficult to provide extensive aid. In 1932, the State of Wisconsin established the first unemployment insurance law in the US, which served as a forerunner for the unemployment insurance provisions of the Social Security Act of 1935.

4.4 Federal law requires state unemployment insurance systems to meet certain requirements if employers are to receive their tax credit against the federal tax and if the state is to receive federal grants for administration. These requirements are intended to ensure that a state's unemployment insurance system is fairly administered and financially secure.

4.5 One of these requirements is that all tax payments collected under state laws be deposited in the unemployment trust fund in the Department of the Treasury. The fund is invested as a whole, but each state has a separate account to which its deposits and its share of interest on investments are credited. A state may withdraw money from its account in the trust fund at any time, but only to pay unemployment insurance benefits. Thus, the benefits are paid exclusively through a public fund. (Please refer to Appendix I for the details of federal requirements.)

4.6 Aside from federal requirements, each state has the responsibility for the content and development of its unemployment insurance law. The state itself decides the amount and duration of benefits; the payroll tax rates; and the eligibility requirements and disqualification provisions. The state also directly administers the systems -- collecting tax payments, maintaining wage records, taking claims, determining eligibility, and paying unemployment insurance benefits to unemployed workers.

5. Objectives of Unemployment Insurance System

5.1 In the long history of implementing unemployment insurance system, the federal government had established different committees to review and propose measures to reform the system. In 1969, the Committee on Unemployment Insurance Objectives published a report entitled *Unemployment and Income Security: Goals for the 1970's* to discuss primary and secondary objectives of the unemployment insurance system.[3]

5.2 In the report, the Committee stressed that unemployment insurance system serves both primary and secondary objectives. The primary objectives of unemployment insurance system are to provide financial help to workers during temporary periods of involuntary unemployment and provide time for the unemployed workers to find suitable jobs. The secondary objectives of unemployment insurance system are to stabilize the economy during economic recessions and improve the utilization and allocation of labour resources by enabling the unemployed workers to find jobs consistent with their work skills and experience from previous employment.

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3 Committee on Unemployment Insurance Objectives, *Unemployment and Income Security: Goals for the 1970's, A Report of the Committee on Unemployment Insurance Objectives,* 1969.

PART 3 - STATE UNEMPLOYMENT INSURANCE PROVISIONS

6. Coverage

6.1 The number of persons covered by the states' unemployment insurance systems increased in the 1990s. Approximately 123.5 million workers (86.7% of the active labour force[4]) were covered by unemployment insurance at the end of 1998, comparing to the 1992 corresponding figure of 108 million workers.

6.2 Originally, the unemployment insurance system covered primarily industrial and commercial workers in private industry. In the 1970s, the federal unemployment insurance law was amended to add substantially to the number and types of workers protected under the state unemployment insurance systems.

6.3 Employees in private firms, state and local governments, and non-profit organizations are subject to the law on unemployment insurance benefits. Private employers in industry and commerce are subject to the law if they have one or more employees in 20 weeks during the current or preceding calendar year, or if they pay wages of US$1,500 (HK$11,617) or more during any calendar quarter in the current or preceding calendar year.

6.4 Federal civilian employees and ex-service members have been brought under the unemployment insurance system through special federal legislation. Unemployment insurance benefits for these persons are financed through federal funds but administered by the states and paid in accordance with state laws.

6.5 Domestic employees in private households are subject to the law if their employers pay wages of US$1,000 (HK$7,745) or more in any calender quarter. In addition, agricultural workers are covered if they work on farms with a quarterly payroll of at least US$20,000 (HK$154,900) or employing ten or more employees in 20 weeks of the year.

6.6 However, states are allowed not to include certain occupations such as self-employment, service for relatives, service of patients in hospitals, and certain seasonal camp-workers in the unemployment insurance systems. This arrangement is in line with relevant International Labour Organization (ILO) Conventions.

4 At the end of 1998, the labour force and the level of total unemployment stood at 141.3 million and 5.9 million, respectively. Hence, the unemployment rate was 4.2%.

7. Eligibility Requirements for Unemployment Insurance Benefits

7.1 In the United States (US), workers whose employers make payments to state unemployment funds, federal civilian employees, and ex-service members are eligible if they are involuntarily unemployed, able to work, available for work, actively seeking work, and meet the eligibility and qualifying requirements of the state law. This arrangement is in line with relevant ILO Conventions. Workers who meet these eligibility conditions may still be denied unemployment insurance benefits if they are found to be responsible for their own unemployment. Individual state information and eligibility requirements for unemployment insurance benefits are available from local employment offices.

<u>Qualifying Wages and Work Requirements for Unemployment Insurance Benefits</u>

7.2 A worker's monetary unemployment insurance benefit rights are based on his employment in covered work over a prior reference period, called the "base period." In most states, the base period is the first four quarters of the last five completed calendar quarters preceding the claim for unemployment insurance benefits. In addition, most states require employment in at least two calendar quarters of the base period. This arrangement is in line with relevant ILO Conventions.

7.3 All states require unemployed workers to earn a specified amount of wages during their base periods before they are entitled to the payment of benefits. It is worth noting that there are minimum and maximum weekly benefits. The maximum potential benefit is the maximum weekly benefit multiplied by the maximum potential duration of weeks of unemployment insurance benefits.

7.4 The amount of wages that must be earned during the base period is mainly stated in these two ways:

1. Multiple of Weekly Benefit or High-Quarter Wages: Most states express their earning requirement in terms of a specified multiple of the weekly benefit amount (commonly 30) or of high-quarter wages[5] (commonly 1.5). For example, if the weekly benefit is US$150 (HK$1,162), the worker needs qualifying wages of US$4,500 (HK$34,853). If high-quarter wages are used, the worker must have earned in the base period 1.5 times the amount earned in the highest quarter of that base period.

2. Flat Qualifying Amount: Some states specify a flat minimum amount of earnings in the base period, ranging from US$1,000 (HK$7,745) to US$3,000 (HK$23,235), to qualify for unemployment insurance benefits.

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[5] This refers to the highest quarterly wages so as to reflect the earnings for full-time work.

7.5 If an unemployed worker meets the state requirements, his eligibility extends throughout a "benefit year", a 52-week period usually beginning on the day or the week for which the worker first filed a claim for unemployment insurance benefits. No state allows a claimant who has received unemployment insurance benefits in one benefit year to qualify for unemployment insurance benefits in a second benefit year unless he or she had intervening employment. This arrangement is in line with relevant ILO Conventions.

Other Requirements for Unemployment Insurance Benefits: Free from Disqualification

7.6 All states require that for claimants to receive unemployment insurance benefits, they must be able to work and must be available for work -- that is, they must be in the labour force and their unemployment must be due to lack of work. Evidence of willingness to work is the filing of claims and registration for work at a state public employment office. Most states also require that in order to qualify for unemployment insurance benefits, the unemployed workers make a job-seeking effort independent of the state's effort.

7.7 Most states have disqualification provisions that restrict unemployment insurance benefit eligibility of the unemployed workers under specified conditions. The major causes for disqualification from benefit eligibility are voluntary separation from work, discharge for misconduct, refusal of suitable work, and labour disputes.

7.8 In the US, disqualification serves at least to delay a worker's receipt of unemployment insurance benefits. The disqualification may be for a specific uniform period, for a variable period, or for the entire period of unemployment following the disqualifying act. Some states not only postpone the payment of unemployment insurance benefits but also reduce the amount due to the claimant. However, states cannot deny unemployment insurance benefits to a claimant if he or she refuses to accept a new job under substandard labour conditions.

Waiting Period

7.9 Nearly all states require a waiting period of one week of total unemployment before the unemployment insurance benefits can begin. This arrangement is in line with relevant ILO Conventions. Three states pay unemployment insurance benefits retroactively for the waiting period if the unemployment lasts a certain period or if the employee returns to work within a specified period. The purposes of the waiting period are to eliminate short term claims, hold down system costs, reduce administrative expenses, and provide time to process claims.

8. Types and Amounts of Unemployment Insurance Benefits

8.1 In the US, under all state laws, the weekly benefit amount -- that is, the amount payable for a week of total unemployment -- varies with the worker's past wages with maximum and minimum limits. In 1998, nearly eight million people received a total of US$21.9 billion (HK$169.6 billion) in unemployment insurance benefits whereas the average weekly benefit was US$195 (HK$1,510). In the same period, some 6.3 million employers paid US$22.2 billion (HK$171.9 billion) to finance the unemployment insurance system.

Weekly Unemployment Insurance Benefit Amount

8.2 Several methods are used to determine the weekly unemployment insurance benefit amount. Three-fourths of the states use a formula that compute weekly unemployment insurance benefit as a fraction of the wages in one or more quarters of the base period. Most commonly, the fraction is taken of wages in the quarter during which wages were highest because this quarter most nearly reflects full-time work. In most of these states, the same fraction is used at all unemployment insurance benefit levels. Six states compute the weekly unemployment insurance benefit amount as a percentage of annual wages. Five states base the weekly unemployment insurance benefit directly on average weekly wages during a specified recent period.

8.3 The amount of unemployment insurance benefits is about 50% of the worker's previous earnings. This arrangement is in line with relevant ILO Conventions.

Maximum and Minimum Unemployment Insurance Benefits

Maximum Weekly Unemployment Insurance Benefits

8.4 All states have minimum and maximum limits on the weekly unemployment insurance benefit amounts. The maximum weekly unemployment insurance benefit may be either a fixed dollar amount or a flexible amount by which the maximum benefit is adjusted automatically based on the weekly wages of covered employees. The majority of states have adopted the latter arrangement. In these states, the maximum unemployment insurance benefit is stated as a percentage of the statewide average weekly wage -- from 50% to 70%. A flexible maximum weekly unemployment insurance benefit eliminates the need for amending the flat maximum statutory dollar amount as wage levels change. The purpose of setting a maximum level on the weekly benefit amount is to conserve the fund and to prevent inordinately high benefits being paid to any individual claimant.

8.5 In 1998, the maximum weekly unemployment insurance benefits for all states and territories varied from US$133 (HK$1,030) in Puerto Rico to US$390 (HK$3,021) in New Jersey.

Minimum Weekly Unemployment Insurance Benefits

8.6 Most states provide fixed dollar minimum. The minimums on weekly unemployment insurance benefits are set by states to relieve the administrative burden of processing weekly payments smaller than some reasonable amount. In 1998, the weekly minimum unemployment insurance benefits ranged from US$5 (HK$38.7) in Hawaii to US$87 (HK$674) in Indiana.

8.7 In the US, the federal minimum wage is US$5.15 (HK$39.9) an hour. If a person works 35 hours a week, the weekly wage is equivalent to US$180 (HK$1,397). Hence, it can be seen that the minimum weekly unemployment insurance benefit amount is lower than the income of a worker who earns minimum wage. The minimum weekly unemployment insurance benefit is not intended to relate to the federal minimum wage or quantify the needs of the lowest income group. It should be noted that the federal and state governments operate a number of public assistance programmes to provide benefits for persons in need. To be eligible for these programmes, a person must have income and assets below some officially defined standard (see Part 8 for details).

Dependents' Allowances

8.8 Twelve states also pay additional allowances for eligible dependants, including a non-working spouse and children under the age of 18. The amount paid per dependent varies considerably by state but generally is US$40 (HK$310) or less per week and, in the majority of states, the amount is the same for each dependent.

Unemployment Insurance Benefits for Partial Unemployment

8.9 The states also have provisions for the payment of reduced unemployment insurance benefits for partial unemployment. A worker is considered partially unemployed during a week of part-time work if the amount earned from the regular employer or from odd jobs is less than the weekly benefit amount. The benefit paid for a week of partial unemployment is usually the weekly unemployment benefit less wages earned in the week.

9. Duration of Unemployment Insurance Benefits

9.1 All but two jurisdictions set a statutory maximum of 26 weeks of benefits in a benefit year. This arrangement is in line with relevant ILO Conventions. Massachusetts and Washington use 30 weeks. Most jurisdictions vary the duration of unemployment insurance benefits through various formulas that relate potential duration to the amount of former earnings or employment (see paragraph 9.5 for details). Twelve states have a uniform duration of unemployment insurance benefits for all unemployed workers.

9.2 The average duration of unemployment insurance benefits paid decreased in the 1990s. The 1998 average duration of unemployment insurance benefits was 14.5 weeks, down from the 1992 corresponding figure of 16.2 weeks.

9.3 The figures of initial claims and weeks claimed also decreased steadily in the 1990s which were 15.1 million and 105.2 million in 1998, respectively. The downward trends were due apparently to the improvements in economic performance.

10. Extended Unemployment Insurance Benefits

<u>State Trigger of Extended Unemployment Insurance Benefits</u>

10.1 In the 1970s, a permanent federal-state programme of extended unemployment insurance benefits was established for workers who have exhausted their entitlement to regular state benefits during periods of high unemployment. The programme is financed equally from federal and state funds.

10.2 Extended unemployment insurance benefits are triggered when unemployment among insured workers in an individual state averages 5% or more over a 13-week calendar period, and is at least 20% higher than the rate for the same period in the last two years. If the insured unemployment rate (IUR) reaches 6%, a state may at its discretion disregard the 20% requirement in initiating extended benefits. This mechanism is known as the IUR trigger of extended unemployment insurance benefits.

10.3 Once triggered, extended unemployment insurance benefits provisions remain in effect for at least 13 weeks. When a state's benefit period ends, extended unemployment insurance benefits to individual workers also end, even if they have received less than their potential entitlement and are still unemployed. Further, once a state's benefit period ends, another statewide period cannot begin for at least 13 weeks.

10.4 Most eligibility conditions for extended unemployment insurance benefits are determined by state law (and they are payable at the same rate as the weekly amount under the state programme). However, under federal law a claimant applying for extended unemployment insurance benefits must have had 20 weeks in full time employment (or the equivalent in insured wages). A worker who has exhausted regular unemployment insurance benefits is eligible for a 50% increase in duration, to a maximum of 13 weeks of extended unemployment insurance benefits. There is, however, an overall maximum of 39 weeks of regular and extended unemployment insurance benefits. Nine states activated the extended unemployment insurance benefits during the economic downturn of 1991.

Optional Alternative Trigger of Extended Unemployment Insurance Benefits

10.5 In 1992, the federal government modified the permanent extended unemployment insurance benefits programme to provide more protection on an ongoing basis. Effective March 1993, states have the option of using an alternative trigger for the payment of extended unemployment insurance benefits based on the state's total unemployment rate (TUR) rather than on the insured unemployment rate (IUR). Under the alternative trigger, extended unemployment insurance benefits are payable when the state's seasonally adjusted TUR for the most recent three-month period exceeds 6.5%, and that rate is at least 110% of the state average total unemployment rate in the corresponding three-month period in either of the two preceding years.

10.6 States triggering the extended unemployment insurance benefits programme using the optional alternative trigger also provide for an increase in the maximum duration of extended unemployment insurance benefits under certain conditions. If the average TUR exceeds 8% and is also at least 110% of the state average total unemployment rate in the corresponding three-month period in either of the two preceding years, the maximum duration of extended unemployment insurance benefits is increased from 13 weeks to 20 weeks. Seven states authorized the TUR trigger of extended unemployment insurance benefits between 1992 and 1998.

11. Taxation of Unemployment Insurance Benefits

11.1 All unemployment insurance benefits are now taxable as a result of the Tax Reform Act of 1986. Under an earlier law, only part of a recipient's unemployment insurance benefits was subject to the federal income tax.

11.2 The taxation of unemployment benefits is progressive in all states. In 1998, about 18% of the unemployment insurance benefits paid out were recovered by taxation. The tax rate ranged from 5.6% on an annual income of less than US$10,000 (HK$77,450) to 30% on an annual income of over US$100,000 (HK$774,500).

PART 4 - FINANCING UNEMPLOYMENT INSURANCE SYSTEM

12. Financing Arrangements

12.1 In the United States (US), except in Alaska, New Jersey and Pennsylvania, state unemployment insurance programmes are financed by payroll taxes paid by employers on the employees' wages. States deposit their respective payroll taxes in their federal unemployment trust fund accounts and withdraw funds to cover the costs of state benefits and half of the extended benefits. Two separate federal accounts are for administration and extended unemployment insurance benefits; they are funded by the federal payroll tax.

12.2 Effective January 1985, all employers who are covered by the unemployment insurance system are charged 6.2% of the first US$7,000 (HK$54,215) annually for each worker's covered wages. Employers receive a 5.4% tax credit, leaving a net effective tax rate of 0.8% of taxable wage. It should be noted that the actual payroll taxes paid by employers depend on the employers' record of employment stability. All jurisdictions in the US use a system, called experience rating, as described in paragraphs 12.4 and 12.6 below.

12.3 The major reasons why nearly all states in the US do not require employees to finance the unemployment insurance system are: (i) employees should not finance the unemployment insurance system because they have no control over their unemployment; (ii) employees oppose to finance the unemployment insurance system because the contributions will reduce take-home pay and the employees already bear the tax burden as consumers in the form of higher prices; and (iii) labour unions may demand higher wages if employees have to finance the unemployment insurance system.

Experience Rating

12.4 Although states have a standard tax rate of 6.2% of taxable payroll, the actual tax paid depends on the employer's record of employment stability, measured by benefit-cost[6] attributable to former employees. This system, called experience rating, has been put in place in all states. (See Appendix II for the arguments for and against experience rating.)

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6 Benefit refers to the amount of unemployment insurance benefit payable to former employees, and cost is the amount of payroll tax paid by an employer.

12.5 Employers with favourable benefit-cost experience are assigned lower tax rates than those with less favourable experience. Employers are required to meet certain federal and state requirements before they are eligible for experience rating. First, most states require new employers to have one to three years of operation before experience rating is used. Second, many states require a minimum balance in the unemployment trust fund before any reduced rates are allowed. The purpose of this solvency requirement is to make certain that the fund is adequate to pay benefits. In some states, it is possible for an employer with a good experience rating to be assigned a tax rate as low as 0.5%; the highest maximum rate is 10% (in Arizona and Tennessee).

12.6 Payroll tax rates may also be modified according to the current balance of each state's unemployment trust fund. When the balance falls below a specified level, payroll tax rates will be raised.

PART 5 - ADMINISTRATION OF UNEMPLOYMENT INSURANCE SYSTEM

13. Administration

13.1 The federal functions of the unemployment insurance programme are chiefly the responsibility of the Employment and Training Administration's Unemployment Insurance Service in the Department of Labour. It verifies each year that state programmes conform with federal requirements, provides technical assistance to the state agencies, and serves as a clearing-house for statistical data. The Department of the Treasury collects payroll taxes, and the Treasury maintains the Unemployment Insurance Trust Fund.

13.2 Each state administers its unemployment insurance law by maintaining records, collecting payroll taxes, determining eligibility, processing claims, and paying unemployment insurance benefits. Each state is required to designate an employment security agency to perform these functions. The majority of states have placed the employment security agency in the state labour department. Some states may use an independent department, board, or commission to administer the system.

13.3 State agencies operate through local employment offices which process claims and act as employment exchanges by providing job information and placement services. The unemployed worker normally registers for work at the public employment office. He usually files a weekly claim for unemployment insurance benefits at the same office. In most cases, the claims may be filed by telephone or mail. Unless there is a good cause for late reporting, the worker must file for benefits within seven days after the week for which the claim is made. The employment security agency administering the programme usually pays the unemployment insurance benefits by check on a biweekly basis.

Appeal Channel

13.4 Federal law also requires that states must provide workers whose claims are denied benefits an opportunity for a fair hearing before an impartial tribunal. There are two levels of administrative appeal: first to a referee or tribunal, and then to a board of review. Decisions of the board of review may be appealed to the state courts in all jurisdictions. The amount of time the claimant has to file the appeal varies by state and ranges from seven to 30 calendar days after an unemployment insurance benefit determination is made.

Penalties

13.5 Any person who knowingly makes a false statement to obtain any unemployment insurance benefit payment will be fined not less than US$100 (HK$774.5) and more than US$500 (HK$3,873) or imprisoned not more than 90 days, or both.

13.6 In addition, states are empowered to disqualify the claimant benefits from two to 23 weeks under specified conditions. The major causes for disqualification are voluntary separation from work, discharge for misconduct, refusal of suitable work, and labour disputes.

PART 6 - ANALYSIS

14. Adequacy of Unemployment Insurance Benefits

14.1 One of the most important issues is the adequacy of weekly unemployment benefits. Each state determines the amount and duration of the weekly benefits.

14.2 Although there is no general agreement concerning the principles to follow in determining weekly unemployment insurance benefits, states agree on three points. First, unemployment insurance benefits should be related to the worker's previous earnings. Second, there should be a limit on the maximum amount paid to any individual; all states place limits on the weekly benefit amount. Finally, unemployment insurance programmes are social insurance programmes that operate on the assumption of presumed need. This means that recipients in a given category (typically based on previous earnings and employment) require a certain level of benefits.

14.3 The gross replacement rate (i.e. the ratio of weekly pretax benefits to pretax wages over some specified time period) is commonly used to determine whether or not the unemployment insurance benefits are adequate.

<u>Replacement Rate</u>

14.4 The ILO has recommended that the replacement rate should be at least 45%. In the US, current replacement rate is around 50% (depending on the states) which is considered adequate to meet the income maintenance intent of the programme.

15. Unemployment Insurance Benefits and Incentives for Job Search and Employment

15.1 There is a view that the payment of unemployment insurance benefits diminishes the recipient's incentive to work or to seek work. The disincentive argument is commonly used against unemployment insurance.

15.2 Researchers have tested the effects of unemployment insurance benefits on the level and duration of joblessness in the US. They measured how changes in various parameters of the unemployment insurance system such as the weekly benefit amount, the replacement rate, and the entitled duration of benefits, had influenced the duration of insured unemployment. It is worth noting that no two studies were exactly comparable. They differed with respect to the types of data used, the specifications of the hypotheses tested, the definitions of the variables, the behavioural assumptions adopted, and kinds of analytical approaches applied.

15.3 Despite their non-comparabilities and varying results, the studies did provide evidence in support of the effects hypothesized. For example, after reviewing the methodology and findings of a number of studies of the effects of unemployment insurance on the duration of unemployment, Hamermesh[7] concluded that:

> "*the best estimate -- if one chooses a simple figure -- is that a 10 percentage point increase in the gross replacement rate leads to an increase in the duration of insured unemployment of about half a week when labour markets are tight. This is not an exact figure, but it does appear that there is some effect, certainly above zero and probably less than one week.*"

15.4 Katz and Meyer[8] (1990) found that a 10 percentage point rise in the unemployment insurance wage replacement rate increased the average duration of insured unemployment by 1.5 weeks. Another important study conducted by Davidson and Woodbury[9] (1996) found that a "*10 percentage point increase in the unemployment insurance wage replacement rate can be expected to increase in the unemployment duration of unemployment insurance claimants by between 0.3 and 1.1 weeks*".

15.5 In sum, findings from empirical research done provided some support for stricter benefit eligibility rules and less generous payment levels so as to minimize work disincentives.

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7 Hamermesh, *Jobless Pay and the Economy,* Johns Hopkins University Press, 1977, P. 37.

8 Katz and Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics*, 1990, p.45-72.

9 Davidson and Woodbury, "Unemployment Insurance and Unemployment: Implications of the Reemployment Bonus Experiments, *Advisory Council on Unemployment Compensation: Background Papers*, Vol. 3, 1996.

16. Reviewing the Unemployment Insurance System

16.1 The most recent review was undertaken by the Advisory Council on Unemployment Compensation established by the US Congress in 1991 to look at unemployment insurance policy issues. The Advisory Council reviewed the unemployment insurance system and completed its final report in 1996. The recommendations on a broad range of issues are summarized as follows[10]:

1. Coverage of Agricultural Workers: The exemption of agricultural workers on small farms from unemployment insurance coverage should be eliminated.

2. Adequacy of Unemployment Insurance Benefits: For eligible workers, each state should continue to replace at least 50% of lost earnings over a six-month period, with a maximum weekly benefit equal to two-thirds of the state's average weekly wage.

3. Setting the Unemployment Insurance Benefit Standards: The federal government should not set any uniform benefit standard. Instead, the states should be urged to adopt a series of approaches to unemployment insurance eligibility, with the principal goal of improving benefit eligibility and adequacy for low-wage, part-time, intermittent, and seasonal workers.

4. Eligibility for Benefits: Some unemployed workers do not qualify for unemployment insurance benefits because of the state's definition of base period. Many states define the base period as the first four of the past five completed calendar quarters. In these states, between three and six months of an individual's most recent work experience is excluded in determining eligibility for benefits. All states should therefore use an alternate base period that would include the current calendar quarter if such use would enable the applicant to meet the state's monetary eligibility requirements.

5. Extended Benefits Trigger: The extended unemployment insurance benefit system should be triggered off once a state's total unemployment rate exceeds 6.5%.

10 Advisory Council on Unemployment Compensation, *Defining Federal and State Roles in Unemployment Insurance: A Report to the President and Congress*, 1996.

6. Financing Unemployment Insurance Benefits: Forward funding of the unemployment insurance system should be encouraged to ensure sufficient balances in the individual state trust funds to finance benefits in future recessions. Forward funding means the financing should be changed so that reserves are built during periods of prosperity and drawn during recessions.

7. Ensuring Adequate Reserves: Each state should be encouraged to accumulate reserves sufficient to pay at least one year of unemployment insurance benefits at levels comparable to its previous high cost. Highest cost is defined as the average of the three highest annual levels of benefits the state paid in any previous 20 calendar years.

8. Higher Federal Taxable Wage Base: The federal taxable wage base should be raised to US$9,000 (HK$69,705). The taxable wage base should be adjusted annually by the Employment Cost Index.

9. Administrative Matters: Key recommendations include creating state-by-state unemployment databases of comparable system data, improving the state employment and wage reports, and developing a national wage record database.

PART 7 - PUBLIC ASSISTANCE PROGRAMMES

17. Basic Characteristics

17.1 Unemployed persons who have exhausted their unemployment benefits and are still unemployed may be eligible for public assistance programmes. It should be noted that there is no unemployment assistance programme in the US. The public assistance programmes are available to the eligible individuals or families, and not specially offered to the unemployed. Nonetheless, a strong work requirement is stipulated in the Temporary Assistance for Needy Families programme.

17.2 The federal and state governments operate a number of public assistance programmes such as Temporary Assistance for Needy Families (TANF), Food Stamp programme, Housing Benefits, General Assistance, and Earned Income Tax Credit (EITC) to provide social welfare benefits for persons in need. To be eligible for these programmes, a person must have income and assets below some officially defined limits. These benefits are adjusted to the individual's or family's financial resources and needs.

17.3 The social welfare benefits are generally financed out of the general revenues of government rather than from specific earmarked taxes. Federal grants are available to the states to help finance the costs of the joint programmes.

18. Temporary Assistance for Needy Families

18.1 The Temporary Assistance for Needy Families (TANF) provides assistance and work opportunities to needy families. In 1996, it replaced the Aid to the Families with Dependent Children (AFDC) programme,[11] the Emergency Assistance for Needy Families (EA) programme, and the Job Opportunities and Basic Skill (JOBS) programme. The federal government provides funding to each state.

<u>Basic Characteristics of Temporary Assistance for Needy Families Programme</u>

18.2 Subject to broad federal guidelines, each state can design its own programme, specify the groups that are covered, establish the eligibility requirements, and determine the amount of cash grants.

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[11] AFDC provided cash assistance to needy families based on need, income, resources, and family size.

Eligibility

18.3 The TANF law has strict work requirements for employable adults. Nearly all adult recipients must work after two years of assistance (or less at the state's option), otherwise, their cash assistance will be reduced or terminated. Each state may require parents to work a prescribed number of hours per week: single parents, 30 hours; couples, 70 hours. States may exempt parents of children under age one from any work requirements. Work activities include paid employment, on-the-job training, and job educational programmes. States make an initial assessment of recipients' skills, and can develop personal responsibility plans that identify needed education, training, and job placement services needed.

18.4 Adult recipients who are not working may have to participate in community service employment after receiving benefits for two months. This requirement does not apply to single parents with children under age six who are unable to obtain needed child care.

Means Test

18.5 Each state establishes its own means test with respect to income and assets. In most states, financial assets cannot exceed US$4,000 (HK$30,980) for one person and US$6,000 (HK$46,470) for a couple.

Benefit Levels

18.6 Monthly cash benefits are based on need and family size and are subject to maximum limits. A standard of need is established for each family, which is relatively low in most states. For example, in 1997, in New York, the standard of need for a three-person family was US$535 (HK$4,144) monthly, and the maximum monthly grant to such families was about US$400 (HK$3,098). However, in determining the amount of the monthly grant, a certain amount of income is not counted. In most states, 20% of an applicant's gross income is disregarded considering work-related and child-care expenses.

Duration

18.7 The maximum duration for TANF benefits is five years but states may specify a shorter maximum duration.

Tax Treatment

18.8 The TANF benefits are not taxable.

Financing

18.9 The federal government provides each state with a basic block grant based on past federal expenditures for programmes that were replaced. In addition, states may receive three additional grants: (i) a bonus fund for states which can reduce unemployment; (ii) a contingency fund to states that experience high unemployment; and (iii) welfare-to-work grants to encourage welfare recipients to work. The basic grant and three additional grants are all capped.

19. Food Stamp Programme

19.1 The Food Stamp programme was changed to its modern form in 1964, but it originated as the Food Stamp Plan in 1939 to help the needy. Expansion of the programme occurred most dramatically after 1974, when Congress required all states to offer Food Stamps to low income households.

19.2 The programme issues monthly allotments of coupons that are redeemable at retail food stores, or provides benefits through electronic benefit transfer (EBT). The EBT system allows Food Stamp customers, using a plastic card similar to a bank card, to buy groceries by transferring funds directly from a food stamp benefit account to a retailer's account. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 requires all states to convert to EBT issuance by the year 2000. Food Stamp eligibility and allotments in all states are based on household size, income, and assets.

Eligibility

19.3 To participate in the programme, households may have no more than US$2,000 (HK$15,490) in countable resources such as a bank account. Certain resources are not counted such as real estate asset. In addition, a household's gross income must be less than the federal income limits.

Benefit Levels

19.4 An estimated 28.6 million persons per month participated in the Food Stamp programme in 1998. The average monthly value of the Food Stamp per person was about US$92 (HK$713) and the total value of benefits issued during the year was around US$26.3 billion (HK$203.7 billion).

Tax Treatment

19.5 The Food Stamp benefits are not taxable.

Financing

19.6 The federal government, through general revenues, pays the entire cost of the Food Stamp benefit, but federal and state social welfare agencies share administrative costs.

Administration

19.7 The Food Stamp programme is operated through state welfare agencies and local welfare offices.

20. Housing Benefits

20.1 The Department of Housing and Urban Development (HUD) provides grants to Public Housing Agencies (PHAs) to finance the capital cost of the construction, rehabilitation, or acquisition of public housing developed by PHAs to provide shelter for low income residents at affordable rents.[12]

20.2 In most states, there are two kinds of housing assistance available:

1. Public housing, which is low income housing that is actually operated by the housing authority.

2. The housing authority gives the tenant a rental voucher which subsidizes the rent payments in private housing.

Public Housing

20.3 Public housing is established to provide rental housing for eligible low income households, the elderly, and persons with disabilities. The HUD administers federal aid to local PHAs that manage and operate the housing programme for low income residents.

[12] The first low-rent public housing projects in the US were constructed as the result of the vast public works programme set in motion in 1933 by the National Industrial Recovery Act. The Housing Act of 1937 marked the earliest of the federal housing programmes designed to meet the concerns for the well-being of individuals. The Housing Acts of 1949 and 1954 created the massive urban renewal programmes of the 1950s, and provided a large number of new public housing units for the poor.

Eligibility

20.4 Public housing is limited to low income families and individuals. The PHA determines the individual's eligibility on the basis of (i) the annual gross income; and (ii) whether the applicant qualifies as elderly person, a person with a disability, or as a family.

20.5 PHAs use income limits developed by the HUD. The HUD sets the lower income limits at 80% and very low income limits at 50% of the median income for the place in which the recipient chooses to live. Income limits vary from area to area so an individual may be eligible at one PHA but not at another.

Benefit Levels

20.6 In 1998, the HUD distributed more that US$6.8 billion (HK$52.7 billion) to approximately 3 550 PHAs provided public housing and services to 1.5 million households.

<u>Rental Voucher Programme</u>

20.7 Rental voucher programme is the federal government's programme for assisting low income households, the elderly, and the disabled to rent private housing. When a rental voucher holder finds a unit that the family wishes to occupy, the PHA inspects the dwelling and reviews the lease prior to executing a housing assistance contract with the owner. Under the programme, the rent for the unit usually may not exceed a maximum rent which is determined by the PHA. The rental voucher holder may have to pay 25% of its monthly income towards the rent and utilities.

Eligibility

20.8 Eligibility for a rental voucher is determined by the PHA and is based on total annual gross income and household size. In general, the household's income may not exceed 50% of the median income for the place in which the family chooses to live.

Benefit Levels

20.9 In 1998, about five million households received rental assistance (1.4 million in public housing and the rest in privately owned units.)

Tax Treatment

20.10 Rental voucher amounts are not taxable.

21. General Assistance

21.1 The General Assistance (GA) is a term used to describe assistance provided by state and local governments to needy individuals and households who do not qualify for major assistance programmes and to those whose benefits from other assistance programmes are insufficient to meet basic needs. The GA may either be in cash or in-kind, including such assistance as groceries and rent.

Eligibility

21.2 The eligibility requirements vary from state to state, and may be within a state.

Benefit Levels

21.3 Benefit levels vary from state to state, and may be within a state. Payments are usually at lower levels and of shorter duration than those provided by federally financed programmes. In 1998, the benefit level ranged from US$150 (HK$1,162) to US$200 (HK$1,550) for a person, and about 1.1 million persons received the GA.

Tax Treatment

21.4 The GA benefits are not taxable.

Financing

21.5 The GA is usually financed by state and local governments, but in about one-fourth of the states it is financed from local funds only.

Administration

21.6 The GA may be administered by state welfare agencies or local agencies.

22. Earned Income Tax Credit

22.1 The Earned Income Tax Credit (EITC) is a refundable federal income tax credit for low income workers. The EITC reduces the amount of tax they owe (if any). Eligible persons who owe no taxes, or whose tax liability is smaller than their tax credit, receive all or part of the EITC as a direct payment.

Eligibility

22.2 The EITC eligibility and credit amounts generally are determined according to the tax filer's earned income and whether they have any children under age 19.

Benefit Levels

22.3 The EITC rate depends on the taxpayer's earned income. The amount that a person could earn in 1998 and still be eligible for the EITC had to be less than: US$9,770 (HK$75,669) without a child, US$25,760 (HK$199,511) with one child, or US$29,290 (HK$226,851) with more than one child. The maximum amount of the EITC was: US$332 (HK$2,571) without a child, US$2,210 (HK$17,116) with one child, or US$3,656 (HK$28,316) with more than one child.

Administration

22.4 The EITC is administered by the Internal Revenue Service as part of its responsibility for collection of federal income taxes.

Appendix I

Federal Requirements for a State to Receive a Tax Offset Against the Federal Payroll Tax and to Receive Federal Grants for Administration

A.1 All payroll taxes must be deposited in the unemployment trust fund in the Department of Treasury. Although the fund is invested as a whole, each state has a separate account, which is credited with its unemployment contributions and its share of investment earnings. All funds withdrawn from the unemployment fund must be used to pay unemployment insurance benefits.

A.2 Unemployment insurance benefits must be paid through public employment offices or other approved agencies.

A.3 The state cannot deny benefits to an unemployed person who refuses to accept a new job because the job is vacant as a direct result of a labour dispute; or because the wages, hours, or conditions of work are substantially less favourable to the individual than similar work in the locality.

A.4 Unemployment insurance benefits are not payable in two successive benefit years to an individual who has not worked in covered employment after the beginning of the first benefit year.

A.5 Unemployment insurance benefits cannot be denied to a person solely because he or she takes part in an approved training programme.

A.6 Cancellation of wage credits or total reduction of unemployment insurance benefit rights for the whole benefit year is permitted only for discharge because of work-connected misconduct, fraud, or disqualifying income.

A.7 Government entities and non-profit organizations are permitted to finance the cost of unemployment insurance benefits by reimbursing the fund for unemployment insurance benefits paid to their former employees (instead of by paying payroll taxes).

A.8 Unemployment insurance benefits cannot be denied solely on the basis of pregnancy.

A.9 Unemployment insurance benefits must be reduced by the amount received from any public or private pension.

A.10 Claimants whose unemployment insurance benefits have been denied must be given the right to appeal the decision by a hearing.

Appendix II

Arguments for and against Experience Rating

A.1 All jurisdictions in the United States (US) have some type of experience rating by which individual employers' payroll tax rates are based on their own experience. Experience rating is a debatable issue, and a number of arguments are advanced both for and against the concept.

B. Arguments for Experience Rating

Stabilization of Employment

B.1 Experience rating may encourage firms to stabilize employment. Experience rating in unemployment insurance may encourage some employers to reduce their unemployment if they are charged with its costs. Firms may attempt to reduce seasonal unemployment in response to experience rating.

Proper Allocation of Unemployment Costs

B.2 Experience rating may result in the proper allocation of unemployment costs since firms with high unemployment must pay higher payroll tax rates. Under a system of unemployment insurance, employers are considered responsible for the unemployment of their employees. If firms with high levels of unemployment are not charged the proper costs of unemployment benefits, then these costs must be partly paid by other firms. This is considered inequitable to firms that have lower levels of unemployment.

Greater Employer Interest

B.3 Experience rating may encourage greater employer interest in unemployment insurance programmes. Experience rating may cause some firms to have a greater interest in benefit levels and pending unemployment insurance legislation. In addition, employers may have a greater interest in preventing the payment of dishonest claims and in the efficient administration of the programme.

C. Arguments against Experience Rating

Little Control over Employment

C.1 Most unemployment is caused by a deficiency in aggregate demand, cyclical forces, and structural changes in the economy, factors over which firms have little control. In addition, firms in stable industries pay lower payroll tax rates even though they make no determined effort to stabilize their employment. Thus, it is argued that firms with little control over unemployment should not be penalized by the payment of high rates.

Employer Resistance to Benefit Increases

C.2 Some business firms oppose the liberalization of unemployment benefits because of the higher contribution rates they must pay. Many firms evaluate proposed benefit increases in terms of their effect on experience rating and may lobby in the state legislatures to oppose these increases.

Automatic Destabilizer

C.3 Another argument against experience rating is that it is a destabilizer, since payroll taxes increase during recessions when firms are least able to pay. Thus, the recession is aggravated because of the higher payroll taxes that must be paid.

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