

The Adequacy of Unemployment Insurance Benefits

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1. INTRODUCTION

Since the inception of the federal-state unemployment insurance (UI) system nearly sixty years ago, there has been controversy about the adequacy of benefit payments.¹ Opinions have ranged from the view that UI does little more than subsidize leisure to the position that the benefit levels grossly under compensate for the physical and psychic hardships caused by unemployment.

The UI system was designed to be completely separate from relief programs, with eligibility determined by labor force attachment and benefit levels based on prior earnings experience. The benefit objectives of UI were recently set forth by the Advisory Council on Unemployment Compensation (1995, p. 8) in a statement of purpose for the UI system.

The most important objective of the U.S. system of unemployment insurance is the provision of temporary, partial wage replacement as a matter of right to involuntary unemployed individuals who have demonstrated a prior attachment to the labor force. This support should help meet the necessary expenses of these workers as they search for employment that takes advantage of their skills and experience.

In this statement of the Advisory Council on Unemployment Compensation makes clear that the primary goal of UI is providing compensation for wage loss experienced as a result of involuntary unemployment. When making recommendations concerning benefit adequacy the Advisory Council on Unemployment Compensation (1995, p. 20) proposed:

For eligible workers, each state should replace at least 50 percent of lost earnings over a six-month period, with a maximum weekly benefit amount equal to two-thirds of the state's average weekly wages. The Council's aim was to ensure one-half wage replacement *for a large number of beneficiaries*.

The most recent major effort to investigate the adequacy of UI was done in the 1970s by Paul Burgess and Jerry Kingston (1978a, 1978b) who conducted the Arizona benefit Adequacy Study under the sponsorship of the U.S. Department of Labor. The methodology used by Burgess and Kingston closely paralleled that of earlier researchers.² The typical approach is to question a sample of UI recipients about their expenditures on a class of goods and services deemed necessary" and compare the level of UI benefits to the level of these expenses.

Surveys of the type done by Burgess and Kingston, while extremely valuable, have proven to be quite expensive.³ The high cost of gathering data has resulted in small sample sizes, but a more fundamental problem exists with the traditional approach. These studies presume that the

¹See Becker (1960) for an early history of public sentiment on several aspects of UI, and Curtin and Ponza (1980) for a summary of some more recent attitudes.

²Haber and Murray (1966) provided a summary of the state studies done in the 1950s which used the same basic methodology later used by Blaustein and Mackin (1977) and Burgess and Kingston (1978a, 1978b).

³Becker (1961, p. 23) notes that for the benefit adequacy studies done in the 1950s "[t]he time spent per interview averaged about three hours, with a range from one to fourteen hours, exclusive of the time spent in the re-interviews of the more difficult cases."

analyst may determine which categories of expenditures are “necessary” or which items a household may least do without.

The problems of sample size and expenditure category selection, are both addressed in the present study by using a readily available large data set, the Current Population Survey (CPS) Annual Demographic File, and an agnostic approach to measuring unemployment compensation based on the economic theory of consumer-worker behavior. The methodology relies on a natural theoretical approach to estimating the upper limit on unemployment compensation—solve for the lump sum payment, which, when given to an unemployed individual, makes her indifferent between her current lot and her pre-unemployment one. Since UI is not intended to fully compensate the loss an individual experiences as a result of being employed, a financial inducement should remain for returning to work. Knowing the upper limit on the level of benefits is important for setting practical program guidelines.

In the next session a discussion of the accepted norms of benefit adequacy provides the framework for a review of the literature on assessing benefit adequacy. A simple theoretical approach to estimating the upper limit on unemployment compensation is given in Section 3 where explicit formulae for performing the computations are also given. In Section 4 the econometric methods to be used and the samples drawn from the 1992 CPS Annual Demographic File are discussed; basic labor supply results are also presented. Simulation results for a variety of household types, preference structures; and representative state are given in Section 6. The final section presents a summary of the new research findings, and considers program guidelines in the light of the evidence presented.

2. STANDARDS OF BENEFIT ADEQUACY

In his classic monograph *The Adequacy of the Benefit Amount in Unemployment Insurance*, Father Joseph M. Becker (1961, p. 11) noted that; “A satisfactory norm of adequacy must have two elements—one positive, by which it can explain why benefits are as large as they are, and one negative, by which it can explain why they are no larger.” Senator Paul Douglas (1932, p.885) had earlier stated the principles in more substantive form. He suggested that “[t]here is a minimum of life which must be defended by the system of benefits,” and that “[t]he amounts which the unemployed receive in benefits should always be appreciably less than what they would earn if employed [so that]...the temptation to shun work in order to draw the benefit would greatly reduce” (Douglas 1932, p. 4). Douglas proposed that a balancing of these objectives might be achieved if unemployment benefits were to replace approximately one-half of lost wages for individuals who are unemployed and have demonstrated a significant attachment to the labor force.