The Omni...".

FUTURE

A Lesson for the New Federalism?

The underlying premise of the New Federalism, a relatively simple set of ideas, is that the federal government should pass the buck to the states. Federalism, considered efficient and accountable government programs, requires that management that is close to the people. States are better suited to design and operate their public programs than the federal government. The state-federal UI marriage, examined in the recent past, has not been uniform, and the federal government has permitted, and even encouraged, some state UI programs to spend beyond their resources.

Unemployment Insurance: An Old Lesson for the New Federalism?

by Michael F. Bryan

Although the unemployment insurance (UI) system in the United States evolved from the UI system in the United States, the federal government, such as the federal government might look to the UI system's experience to design a specific program. This Economic Commentary discusses the state-federal UI marriage, examines the experience of state UI programs, and highlights recent changes declared at the federal level to improve the current management of the UI system.

Conflict of Interest

Since its inception, the UI system has been a federal labor policy focused on the states. The creation of state-operated UI systems in the early industrial years of America required minimal federal intervention. As the industrial sector of the economy grew, the belief that laborers needed financial protection against income losses associated with business cycles gained support. However, a policy concept at the federal level is not always cordially received at the state level, particularly if states are expected to shoulder part of the policy's financial burden. In the UI system the financing effort of the state programs has not been uniform, and the federal government has permitted, and even encouraged, some state UI programs to spend beyond their resources.

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ment levied a 3 percent payroll tax, called FUTA, 90 percent of which would be waived for employers operating in states having state unemployment compensation programs. The credit against the federal tax could be an effective incentive to employers to design and implement their own state unemployment compensation programs. The credit against the federal tax would be taken in addition to the credit against state unemployment taxes for the same individuals. The FUTA waiver, or credit, can be manipulated to achieve any intended state by-state basis and remains today as a powerful incentive for state governments to cooperate with federal standards.

What (and whose) unemployment-compensation goals does the system serve? The UI system contains elements of income maintenance and redistribution, in addition to its original function as an insurance mechanism. 2 UI income redistribution occurring between industries and across occupations in large part results from program parameters such as maximum-benefit allowances and taxation limits. Inasmuch as many of the intended results of the program are automatic, the UI income redistribution occurring is largely determined by a reduction of the FUTA credit of employers in debtor states.

To encourage more states to offer extended unemployment compensation during periods of severe labor-market conditions, the federal government enacted another voluntary extension of extended-benefits legislation in 1961, called the Temporary Unemployment Compensation Act (TUC). The primary difference between TUC and TEUC was that TUC benefits were funded by federal authority through a 0.4 percent reduction in the normal state unemployment tax rate. Although not widely reaped by states, the TEUC system was financed by a reduction of a 2 percent for FY 1982, net state UI losses are estimated by the Labor Department at $1.7 billion for FY 1982, the state UI programs owed the federal government (see box).

The Financial Crisis of State UI Programs

Most state UI programs became insolvent in the last decade. There is little question, however, that any state UI program would fail to provide benefits, as incentive programs are supported and funded by the federal government (see box). Many states have accumulated debts of very large proportions. These state UI trust losses have become an important component of the federal deficit. Based on an average unemployment rate of 4.5 percent between 1970-79, California maintained UI financial solvency, without federal aid, throughout the entire 10-year period. Inasmuch as state UI tax rates are levied both a state and a federal unemployment tax. State taxes are legislated individually and deposited with the states.

The UI system is funded through a dual taxation arrangement, where employers are levied both a state and federal unemployment tax. State taxes are legislated individually and deposited with the states. The Federal Unemployment Tax Act (FUTA) is an employer payroll tax earmarked for three federally maintained accounts: the Federal Unemployment Insurance Account (FUIA), the Employment Security Administration Account (ESA), and the Federal Extended Unemployment Compensation Account (FEUCA).

Financing the Unemployment Insurance System

The UI system is funded through a dual taxation arrangement, where employers are levied both a state and federal unemployment tax. State taxes are legislated individually and deposited with the states. The Federal Unemployment Tax Act (FUTA) is an employer payroll tax earmarked for three federally maintained accounts: the Federal Unemployment Insurance Account (FUIA), the Employment Security Administration Account (ESA), and the Federal Extended Unemployment Compensation Account (FEUCA). FUIA is a loan account for lending funds to states whose trust accounts are inadequate to support regular extended-benefits program. ESA and FEUCA funds are used to finance extended unemployment benefits.

Most states also provide for a rate minimum to encourage performance of those that meet federal government objectives. The state UI programs currently have serious UI deficits: Illinois ($2.5 billion), Michigan ($1.6 billion), Ohio ($1.1 billion), New Jersey ($0.5 billion). Recent acceleration of unemployment-insurance claims has refinanced a more widespread concern over the financial solvency of state's support of UI obligations. Persistent and high levels of state unemployment rates during periods triggering extended unemployment compensation. A high level of unemployment compensates for the new 13-week extension of the unemployment insurance. In general, UI solvency problems origi-