GAO United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

April 28, 1992

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The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

Although 97 percent of all wage and salary workers are covered under the Unemployment Insurance (UI) program, the proportion of the unemployed who receive UI benefits has declined by one-fifth between 1975 and 1991. The decline in UI recipiency has been widely reported, raising fears that the UI program no longer acts as an effective economic stabilizer or maintains the purchasing power of the unemployed. At your request, we are conducting a study of certain aspects of the UI program. Specifically, we are examining the decline in the proportion of the unemployed who receive UI benefits, the factors contributing to the decline, and the effect of the decline on the program's objectives. As requested by your office, this letter provides some preliminary results from our work on the decline in the recipiency rate and its effect on the program's overall objectives. Our forthcoming report will address the reasons for the decline in the proportion of the unemployed who receive benefits, focusing on federal and state UI law changes.

BACKGROUND

The primary objectives of the UI system are to (1) provide temporary and partial wage replacement to those who lose their jobs through no fault of their own and (2) act as an economic stabilizer during economic downturns. The system, which is operated as a partnership between the federal government and the states, provides for the payment of regular benefits as well as extended benefits during periods of high unemployment. A state UI payroll tax on employers finances regular UI benefits and one-half of the extended benefits program.[1] The federal

[1]The extended benefits program gives unemployed workers additional benefits once they exhaust their regular benefits, which occurs after 26 weeks in most states. Extended benefits are paid on a state-by-state basis during periods of high unemployment.

government levies a payroll tax and uses the proceeds to finance both state and federal UI program administration, pay one-half of the extended benefits program, and create a fund from which loans can be made to states with insolvent UI accounts. During 1991, additional benefits were paid entirely from federal UI funds under a separate program, the Emergency Unemployment Compensation program, enacted in November 1991.

The UI system acts as a stabilizer to the economy because aggregate UI benefit payments typically increase as unemployment rises during recessions--even after adjusting for the unemployment level. Typically, during a recession, the UI recipiency rate increases as unemployment rises, reflecting an increase, among the unemployed, in the number of workers who lose their jobs and a decline in the number of new entrants and reentrants in the labor force.[2] The opposite occurs during a period of economic recovery; the number of job losers declines and, as employment opportunities increase, more new entrants and reentrants are drawn into the labor force. As a result, the UI recipiency rate declines during recovery because those eligible for UI benefits comprise a smaller proportion of the unemployed.

RESULTS IN BRIEF

The ability of the UI program to meet its objectives of temporary and partial wage replacement and economic stabilization has been eroded since the 1970s. Our work shows that, relative to the level of unemployment, there has been a long-term decline in the amount of UI benefit funds being injected into the economy to help stabilize economic activity during recessions. This decrease resulted principally from a decline in the percentage of the unemployed who receive UI benefits, a trend that was particularly notable during the early 1980s. If the UI recipiency rate and benefit payments were at the same level during the 1990-91 recessionary period as during the 1974-75 period, about $20 billion more in UI benefits would have been available to stabilize the economy and maintain a portion of the incomes of the unemployed. Half of this difference was due to a decline in the proportion of the unemployed who received regular UI

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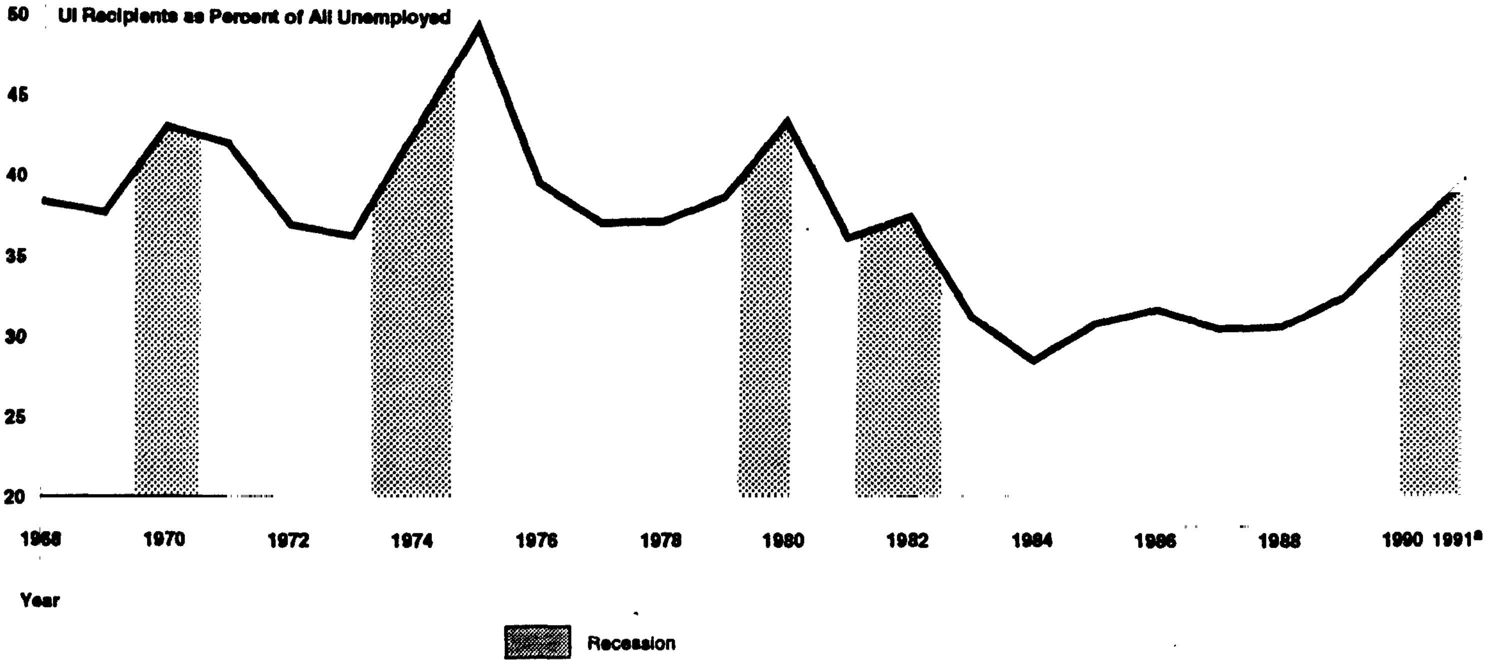
[2]Not all unemployed workers are eligible for UI benefits. New labor force entrants and most reentrants are not eligible because generally they lack sufficient time in UI covered employment. Also, workers who voluntarily leave their jobs may not be eligible or may be eligible only after a waiting period.

benefits, and the other half to a decrease in the payment of extended benefits.

DECLINING IMPACT OF UI RESULTS FROM LOWER PROPORTION OF UNEMPLOYED RECEIVING BENEFITS

The erosion of the UI system since the 1970s is largely a reflection of the decline in the percentage of the unemployed who receive UI benefits.[3] The UI recipiency rate was 49 percent during the 1974-75 recession, was 43 percent during the 1980 recession, and dropped following the 1981-82 recession to 29 percent in 1984 (see fig. 1). UI recipiency increased slowly after 1984, but remained at historically low levels until unemployment began increasing in 1990. In 1991, the percentage of the unemployed who received UI benefits was 40 percent, which was about 20 percent below the peak 1975 level.

Figure 1: Proportion of Unemployed Receiving UI Benefits Has Fallen Since 1975 Peak



aPreliminary data. End of 1990-91 recession has not officially been determined.

[3]UI recipiency includes only those receiving regular benefits, not those receiving extended benefits.

The usual pattern of increasing UI recipiency during a recession did not hold during the 1980s. Although UI recipiency increased as the nation entered a recession in 1980, it declined in 1981 while unemployment remained high. As unemployment rose to a post-World War II high in 1982 (9.7 percent), the UI recipiency rate was 37 percent, similar to that of the 1978-79 nonrecession period. And, in 1983, when unemployment remained high (9.6 percent), the UI recipiency rate declined to 31 percent. In contrast, UI recipiency rose to 43 percent in the 1969-70 recession, and to 49 percent during the 1973-74 recession. During recovery periods following these recessions, UI recipiency did not fall below 36 percent.

The 1990-91 recessionary period showed a more typical pattern, with an increase in the percentage of UI recipients as unemployment increased. However, at 40 percent, the recipiency rate was well below the peak rate of 1975.

LESS UI FUNDING AVAILABLE AS AN ECONOMIC STABILIZER

The economic stabilization provided by the UI system has been lessened since the 1970s. We estimate that, had the UI system paid benefits during the 1990-91 recession at a rate equivalent to its peak rate, that of the 1974-75 recession, about $20 billion more would have been pumped into the economy than actually was in 1990-91. The UI system paid about $50 billion in benefits in the 1990-91 period. Had the system paid benefits to the same proportion of the unemployed as it did in 1974-75, after correcting for inflation and unemployment levels, over $70 billion of benefits would have been paid in 1990 and 1991. Half of the difference was due to a decline in the payment of regular benefits, and half was due to the decrease in extended benefit payments. Similarly, had UI benefits been paid at a rate equivalent to that of 1980, $7 billion additional would have been available as an economic stabilizer in 1990-91.

Most recently, the trend has returned to its traditional pattern of increased UI benefit payments as unemployment rises during recessions. For example, the UI system paid out about $1 billion more in benefits during the 1990-91 recessionary period than it would have at the 1981-82 rate.

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We are continuing our work in response to your request, and our forthcoming report will respond to each of the matters you asked us to address. If you have any questions or need additional information, please call me at (202) 512-7014 or Sigurd Nilsen of my staff at (202) 512-7003.

Sincerely yours,

For Linda G. Morra
Director, Education and
Employment Issues

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