

## The Virginia NEWS LETTER

# Virginia's Unemployment Insurance Program

By Megan Coltson Moyer  
and John L. Knapp

### Introduction

In 2002, the number of unemployed Virginians averaged 152,200 and accounted for 4.1 percent of the labor force, the highest annual jobless rate in six years. Two out of three unemployed persons did not receive unemployment insurance benefits. Virginia's low reciprocity rate (the ratio of insured unemployed to total unemployed) was a result of several factors. Some unemployed persons failed to qualify because they were new labor force entrants or reentrants. Others did not qualify because they did not apply for benefits, they exhausted their benefits, they quit their jobs, they were fired for cause, or they failed to meet other eligibility requirements.

Recognizing the difficulties a slow economy poses for the unemployment insurance program and expressing concern over the low reciprocity rate and trust fund solvency, the Virginia General Assembly in 2001 commissioned a report on the state's unemployment insurance program.<sup>1</sup> Dr. Wayne Vroman, a nationally known expert on unemployment



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insurance systems, was hired to prepare the report. The completed study, *An Analysis of the Virginia Unemployment Compensation System*, was published in late 2002 and is available on the Web.<sup>2</sup> The study had a strong influence on unemployment legislation adopted in the 2003 session of the General Assembly.

### Brief History

The unemployment insurance (UI) program began in 1935 during the Great Depression as a state-federal venture to provide a "program of short-term insurance for the payment of benefits to workers as a matter of right during unemployment which is beyond their control."<sup>3</sup> The program was conceived as a way to partially replace lost wages so that the unemployed would not have to turn to other relief programs and to aid in reemployment by creating a nationwide public job placement system. The UI program also was intended to maintain consumer purchasing power by providing basic benefits based on past earnings rather than on need.



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*Trust fund will  
be critically low  
next year*

## Current UI Program Features

Today, the Virginia Employment Commission (VEC) lists alleviating hardship for the unemployed, preventing unemployment, and promoting reemployment as the UI program's three main objectives. Although preventing unemployment is a laudable goal it is beyond the capacity of the agency.

Under the Commonwealth's current unemployment insurance system, applicants qualify for benefits if they earned a combined \$2,500 in the two highest quarters of the base period and became unemployed through no fault of their own. The base period is defined as the first four of the most recent five quarters of employment. The requirements recently were changed so that, if a claimant does not qualify using this base period, he may attempt to qualify using the most recent four quarters of employment. The minimum weekly benefit is \$50 and the maximum is \$316. Beginning July 2004, the maximum benefit amount will be \$326. Applicants may receive benefits for as many as 26 weeks each year.

Prior to the most recent changes to unemployment insurance, when Vroman was asked to study it, the system was much the same. However, the minimum weekly payment was a lot higher at \$59. (The higher minimum arose from former Governor Gilmore's UI changes following the terrorist strike on Sept. 11, 2001.) Also, the maximum was marginally higher at \$318. The base period was the first four of the last five quarters of employment without exception.

UI payments come from the unemployment insurance trust fund, which is funded by a tax levied on employers. Because employer wage taxes add to total compensation costs, and higher costs reduce the willingness of employers to retain workers or pay higher wages, economists argue that the workers share in the final cost of the tax. The schedule for employer tax payments depends on the current level of trust fund solvency and the employment histories of individual firms.

In addition to the regular tax, there are two surtaxes. One is a pool tax, used to raise funds for the benefits that cannot be obtained from a specific employer because the benefits exceed the employer's prior tax payments or because the employer is no longer in business. The pool tax also is enacted when employees qualify for benefits, but employers could not be equitably taxed (for example, when a now-unemployed worker voluntarily left a job for another that he reasonably believed would be permanent). The other

tax is a fund-building tax that takes effect when the fund's solvency level drops below 50 percent.

## Trust Fund Solvency

Under the Virginia system, adequate trust fund solvency is defined as the ability to pay benefits for 16.5 months out of the current fund balance. Trust fund solvency is measured as the product of the average cost rate (the average of the three highest benefit-to-wage ratios in the past 20 years), total taxable wages paid by employers for the most recent fiscal year, and a multiplier of 1.38.<sup>4</sup> The level of trust fund solvency is found by dividing the most recent June 30 trust fund balance by the adequate fund balance.

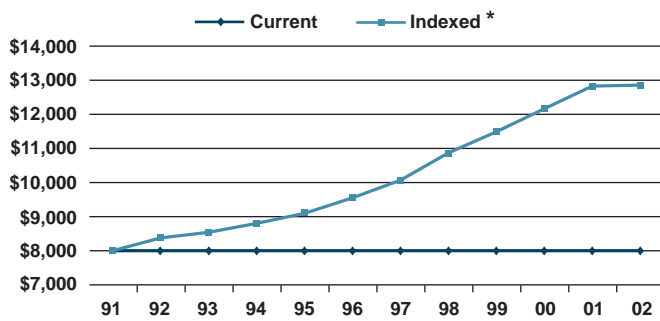
The U.S. Department of Labor, the federal agency that oversees state unemployment systems, uses a slightly different measure of trust fund solvency than the Commonwealth. The Department's "high cost multiple" measure indicates how many months in a year a fund could last without additional employer tax revenue.<sup>5</sup> Using this definition of solvency, the national average in the second quarter of 2003 was 0.62; that is, the average state fund would last just under 7.5 months. According to the Department of Labor, Virginia's high cost multiple for that time period was 0.70 (the fund could last slightly less than 8.5 months).

Even though Virginia's trust fund solvency level is higher than average, employers in the Commonwealth pay significantly lower taxes than employers in most states. In 2002, when the national average employer tax was 0.5 percent of total wages of covered employees, Virginia's average tax rate was 0.2 percent, one of the lowest in the nation. Only Georgia had a lower rate and only Arizona, New Hampshire, and South Dakota matched Virginia's rate.<sup>6</sup>

Virginia Employment Commission analysts project that the trust fund will be critically low next year, when it will drop to 23 percent solvency. In November, the VEC reported that, after the fund building tax is implemented, the fund will recover to over 50 percent solvency by 2006. Vroman's report makes suggestions as to how the trust fund should be maintained and supplemented. He believes that the method of determining trust fund adequacy should be left unchanged, as should the current tax schedule and policy for assigning pool charges. He does, however favor raising the taxable wage base from \$8,000 to \$12,000, adjusting the tax schedule

downward so that the change is revenue neutral, and adopting a higher maximum fund building tax. Virginia's taxable wage base, the amount of annual wages per employee that is subject to the employer tax, has been \$8,000 since 1991. In that year, the average annual wage of taxable covered employees was \$22,908. Eleven years later in 2002 it was \$36,715. Had the taxable wage base been indexed for annual increases in actual wages, it would have been \$12,834 in 2002. This means that a smaller portion of the average wage has become taxable over time, falling from 34.9 percent in 1991 to 21.8 percent in 2002.

Virginia's Taxable Wage Base, Current and Indexed



Source: Data on the average annual wage per taxable covered employee came from the Virginia Employment Commission.  
\*Based on the annual percentage change in the average annual wage per taxable covered employee since 1991.

Securing a certain amount of revenue can be accomplished by either retaining the current tax base and rate schedule or by raising the ceiling on the current tax base and reducing rates. With the current low tax base, reliance on flat rate taxes (like the fund-building tax) places a disproportionately high burden on low-wage firms because a larger portion of their wage bill is taxed than for high-wage firms. Vroman concludes that raising the tax base and reducing rates is sensible because it would reduce this inequity, even though it would not change total UI tax collections.

The average taxable wage base in the nation is \$10,627. Most of Virginia's neighboring states have taxable wage bases close to or equal to Virginia's. The only exception is North Carolina, which uses \$15,900.<sup>7</sup>

Governor Warner addressed trust fund solvency in his legislative recommendations for 2003. The governor proposed extending the look-back date for determining solvency to 1982. Currently, the look back is 20 years. Extending the period to include 1982 would incorporate that year's recession, the worst in recent memory, in the look-back period. When the 1982 recession is not included, the trust fund

appears more solvent than it may actually be, especially given the current condition of the economy.

### Reciprocity Rate

While Virginia outperforms most states in terms of trust fund solvency, the Commonwealth severely underperforms when it comes to UI reciprocity rates. As earlier noted, the reciprocity rate is a measure of the proportion of the unemployed receiving unemployment insurance. Generally, reciprocity is measured using the standard rate—the number of weekly claimants paid by regular UI programs divided by the number of all unemployed workers, although there are several alternate measurements.<sup>8</sup> Virginia's reciprocity rate was 35 percent in 2002 while the national average was 44 percent. Nationally, reciprocity has dropped significantly since the mid-1970s, regardless of what measurement method is used.

A U.S. Department of Labor study attributed much of this drop to a variety of factors. A decline in unionization could have negatively effected reciprocity rates since union workers are more likely than non-union workers to be laid off rather than fired (fired workers are not eligible for UI benefits) and to be informed of UI policies and availability. By making UI benefits taxable, the federal Tax Reform Act of 1986 reduced the overall value of benefits received, potentially discouraging those who would receive the minimum benefit from applying. Geographic shifts in the distribution of unemployed workers from areas with high reciprocity to areas with low reciprocity also could have led to lower reciprocity rates. In some states, administrative and policy changes tightening the requirements for UI eligibility may also have contributed to the decline. One study cited in the review suggested that there was an incentive for states to shift claimants from the UI system to other federally-funded aid programs, since other programs receive a higher share of their funding from the federal government, rather than from the state, although the study did not find this to be a significant contributing factor.<sup>9</sup> Although these reasons address the drop in national reciprocity rates, they do not explain the significant difference in the Virginia and national reciprocity rates.

*Virginia has  
strict standards  
on benefits*

A Virginia Employment Commission Information Paper released in July 2003<sup>10</sup> suggested state-specific reasons for the low reciprocity rate. The paper noted that the level of income a claimant must earn to qualify for benefits is higher in Virginia than all but 10 other states and that, like 31 other states, qualifying earnings must be made in two quarters. Virginia, unlike most states, does not allow employees who leave work to move with a spouse to collect benefits; this is especially significant given Virginia's large, transient military labor force. In order to remain eligible for UI benefits, workers must report job search efforts. And in order to requalify for benefits upon reemployment, workers must be employed for a minimum of 30 days. Both standards are stricter than in most states. The information paper also noted a shift in Virginia's employment from sectors that typically have high filing rates to those with lower filing rates. Although both Virginia and the nation have experienced a pronounced shift away from goods-producing sectors to service-providing sectors that have lower filing rates, the Virginia economy continues to have a higher concentration of services. Additionally, Virginia had the sixth-lowest unemployment rate in the nation at the time of the paper's release. According to the VEC, a low unemployment rate correlates to a low filing rate as potential filers anticipate reemployment.

The state's low reciprocity rate is one of Vroman's chief concerns in his report. Among his suggestions, Vroman proposed the new alternative base period, which subsequently was adopted by the Commonwealth, and went in to effect in July. Vroman also recommended that the VEC undertake a study of the low reciprocity rate and specifically on those who were deemed monetarily eligible, but never received a first payment. At the November 2003 meeting of the Commission on Unemployment, the VEC reported that all but 20 percent of those who did not receive first payments despite being monetarily eligible were ineligible for non-monetary, statutory reasons (voluntary quits, misconduct, refusal of suitable work, etc.).<sup>11</sup>

## Replacement Rate

Vroman asserts that changes also are needed to improve the adequacy of Virginia's UI coverage to those who receive payments. Virginia's average replacement rate (the fraction of their former wages claimants receive as benefits) is 43 percent, significantly higher than the 37.3

percent national average for the 12 months ending in June 2003.<sup>12</sup> This most recent state replacement rate is higher than usual; historically, Virginia's replacement rate has been lower than the national average. It should be kept in mind that replacement rates represent averages; some insured receive benefits exceeding the average amount, while some do not approach the state or national average.

Vroman's proposals include ending the temporary increases in weekly benefits enacted during the Gilmore administration, and setting the maximum weekly benefit level at 50 percent of average weekly wages. However, he does not believe that the basis for calculating weekly benefits should be changed. The statutory replacement rate and the ratio of maximum benefits to average weekly wages are the two most important factors in determining the actual replacement rate.

Vroman also suggested that the unemployment insurance program ultimately would benefit from indexing changes in the maximum weekly benefit to the percentage change in the state's average wage, although he argued that indexation should not be attempted under the economic conditions prevalent at the time of his study. This would allow benefits to keep pace with wages, but could also increase the burden on the system at times of low trust fund balance and high need, such as is occurring now. Governor Warner, in the most recent legislative session, supported indexation, proposing that, beginning Jan. 1, 2004, the maximum benefit amount be set to 50 percent of the state's average weekly wage. Warner suggested indexation be accompanied by the rollback of Governor Gilmore's extended maximum benefit amount in order to avoid a dramatic jump in taxes for business, which would occur if indexation were implemented under the extended benefit. The AFL-CIO backed this proposal. Indexation was opposed by the Virginia Chamber of Commerce,<sup>13</sup> which was concerned about higher employer taxes for its members. Ultimately, indexation was not among the initiatives passed by the General Assembly.

The General Assembly did, however, pass a measure which reduced the amount of a claimant's benefits by 50 percent of Social Security or Railroad Retirement benefits received the same week, provided that such a reduction does not bring the claimants benefits below zero. The Virginia Chamber of Commerce, and others in the business community, did not wish to change the previous

deduction of 100 percent, but proposed the eventually-passed 50 percent as a compromise.

## Some Ideas for Fundamental Changes

The changes suggested in Vroman's study, and those enacted by the General Assembly do not affect the structure of the unemployment insurance system. They attempt to improve the system, but operate under the assumption either that the system is fundamentally sound, or that now is not an appropriate time to attempt wide-reaching changes. Several national economists, however, have made suggestions for broad changes in state UI systems.

Economist Bruce Meyers, in a 1995 *Journal of Economic Literature* article, studied the effects of reemployment incentives designed to encourage UI recipients to find reemployment.<sup>14</sup> He found that a system of monetary bonuses to be rewarded at reemployment caused a small net loss to the unemployment system, and that society more or less broke even under this type of plan. Meyers also expressed concern that net losses would be greater because bonuses induced more people, particularly people with good re-hire prospects, to apply for UI benefits when they otherwise would not have. Meyers also examined job-search programs and found that such programs decreased UI outlays and, in some cases, increased workers' re-hire wages. Vroman did not recommend implementation of an expanded job search program, but did recommend that VEC study ways to fund training programs.

Economist Martin Feldstein proposed a much greater departure from the current UI system.<sup>15</sup> Concerned that the current UI benefit system creates a significant disincentive to reemployment, Feldstein suggested publicly-mandated private unemployment insurance accounts as an alternative. Under Feldstein's scheme, a worker would be required to contribute four percent of his income to an interest-bearing unemployment insurance account. If the worker became unemployed, he would draw his benefits from this account until it ran out, at which time he would receive a government loan at the same rate of interest that other account-holders earned on positive-balance accounts. Any negative unemployment insurance account balance would be forgiven at retirement, and any positive balance would be rolled over to retirement benefits, or distributed to heirs if the worker died before retirement. Such a plan could reduce the disincentive present under the current system, and

would relieve the statutory incidence of the tax on employers.

## Conclusion

Vroman's study does not suggest any changes as radical as those discussed by Meyers or Feldstein. His study finds no pervasive structural problems with Virginia's unemployment system. The most pressing concerns are with the reciprocity rate, particularly among workers who are monetarily eligible but do not collect UI benefits, and with the replacement rate, which has not kept pace with the average wage. With regard to the first concern, Vroman recommended that the VEC conduct a separate study to find reasons for the low reciprocity rate. As for the second concern, Governor Warner supported setting the maximum benefit amount at 50 percent of the state's average weekly wage, but the General Assembly rejected such indexing. A third concern, one which the General Assembly has not addressed, is the inequity imposed on Virginia's low-wage employers by the smaller tax base and higher tax rate. Beyond these concerns, the chief obstacle for Virginia's UI system is maintaining an adequate trust fund balance in the face of continuing economic difficulty.

### ABOUT THE AUTHORS

*Ms. Moyer, who recently acquired her B.A. in economics at the University of Virginia, was employed as a student research assistant at the Cooper Center. Mr. Knapp is the research director of the Cooper Center's Business and Economics Section.*

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### Notes

<sup>1</sup> House Joint Resolution 611 <http://leg1.state.va.us/cgi-bin/legp504.exe?011+ful+HJ611ER>

<sup>2</sup> Wayne Vroman, *An Analysis of the Virginia Unemployment Compensation System* (Washington, D.C.: The Urban Institute, December 6, 2002) <http://www.urban.org/Template.cfm?NavMenuID=24&template=/TaggedContent/ViewPublication.cfm&PublicationID=8242>

<sup>3</sup> "Unemployment Insurance: Purposes and Principles," U.S. Department of Labor, Bureau of Workforce Security, Dec. 1950, p. 1.

<sup>4</sup> The factor is the ratio of 16.5 months to 12 months = 1.38.

<sup>5</sup> The Department of Labor (DOL) calculates an average high cost multiple, which measures how many zero-revenue periods the fund could support if

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payments in each period were equal to the average of the three highest-cost years in the history of the program. This definition can be found on the DOL web site at http://workforcsecurity.doleta.gov/unemploy/content/data\_stats/datasum03/2ndqtr/gloss.asp. See Average High Cost Rate and Average High Cost Multiple.

<sup>6</sup> The rate was derived by dividing total tax collections by total wages of taxable employees for the twelve months ending in the fourth quarter of 2002. Source: U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Data Summary, 2nd Quarter, 2003, http://workforcesecurity.doleta.gov/unemploy/content/data\_stats/datasum03/2ndqtr/sum.asp#wag

<sup>7</sup> U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Data Summary, 2nd Quarter, 2003, http://workforcesecurity.doleta.gov/unemploy/content/data\_stats/datasum03/2ndqtr/sum.asp#wag

<sup>8</sup> Other measurement methods include the All Programs Rate, which considers number of claimants for all programs (regular, extended benefit and federal) as a portion of all unemployed; the Standard Short-term Rate, which counts regular claimants as a percentage of job losers unemployed for less than 27 weeks; and the All Programs Job Loser Rate, which

measures the share of all job losers who are weekly claimants for any of the UI programs.

<sup>9</sup>"Literature Review and Empirical Analysis of Unemployment Insurance Reciprocity Ratios," U.S. Department of Labor, Workforce Security Research Publication, July 1999, http://wdr.doleta.gov/ows-drr/99-7/default.cfm.

<sup>10</sup> Virginia Employment Commission, "Payments of Benefits to Unemployed Virginians," (July 2003).

<sup>11</sup> Virginia Employment Commission, "Report to the Commission on Unemployment Compensation," Power Point Presentation (November 17, 2003).

<sup>12</sup> U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Data Summary, 2nd Quarter, 2003, http://workforcesecurity.doleta.gov/unemploy/content/data\_stats/datasum03/2ndqtr/home.asp

<sup>13</sup> Virginia Chamber Briefings, Feb. 18 and 26, 2003. http://www.vachamber.com/grassroots/legislative\_reports.htm

<sup>14</sup> Bruce Meyers, "Lessons from the U.S. Unemployment Insurance Experiments." *Journal of Economic Literature*, March 1995.

<sup>15</sup> Martin Feldstein and Daniel Altman, "Unemployment Insurance Savings Accounts," National Bureau of Economic Analysis Working Paper, December 1998.

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