

Poor Performance as a Predictable Outcome: Financing the Administration of Unemployment Insurance

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I. Background on administrative financing

- UI administrative financing is an obscure topic (even among UI aficionados)
- Only one of the 63 research papers prepared for NCUC (1980) discussed administrative financing (plus ~4 pages of the NCUC Final Report)
- Only one of the 47 background papers prepared for ACUC (1993–1996) addressed administrative financing
- Discussed briefly in one of the three ACUC reports
- Unmentioned in Blaustein (1993) or O’Leary and Wandner (1996)

Why the obscurity? Administrative funding differs from benefit funding

- A state's regular UI benefits are funded from payroll taxes collected in the state
- Funding for administration comes from the FUTA payroll tax—a flat 0.6% on the first \$7,000 of each employee's annual earnings for states in compliance with the SSA
- If a state is declared out of compliance, the FUTA credit is rescinded and the tax is 6% of the first \$7,000 of each employee's annual earnings
- This is the “stick” that induced the states to adopt UI programs and is available to the federal government to enforce compliance or “encourage” desirable behavior

Despite relative neglect, administrative financing is important

- Not in pecuniary terms: Administrative allocations for FY 2018, 2019, and 2020 were just over \$2.5 billion per year, compared with nearly \$150 billion in regular state benefits paid from April 2020 to March 2021
- But important to the ability of the system to perform its basic functions
 - consumption smoothing—partial income replacement to job losers
 - automatic countercyclical stabilization
- Long lags between initial claims and first benefit payments impede the ability of UI to fulfill these purposes

Administrative funding has been a problem

- Recessions have revealed gaps in the ability of the UI system to deliver benefits to eligible claimants
- Most state systems were overwhelmed in the Covid recession
- Evidence below
- The performance of the UI system was criticized during and after both the Great Recession and the Covid recession
- California State Auditor's report (2021): "Employment Development Department's Poor Planning and Ineffective Management Left It Unprepared to Assist Californians Unemployed by COVID-19 Shutdowns"

Methods of allocating administrative funds have been bureaucratic

- From 1970 until 1996, the federal government used a “Cost Model” to allocate administrative funds
- Under the Cost Model, studies were performed to determine the time required to perform various tasks (“minutes per unit”)
- The approach was criticized both within the system for its complexity (Kohl 1990) and because it created an incentive for states to inflate the time required to perform tasks (Davidson and Martin 1998)

- Since the late 1990s, DOL has used the “Resource Justification Model” (RJM), which still bases a state’s administrative budget on workload
- Each state submits detailed information about its operations to the National Office, and the RJM is used to calculate the number of staff years required and cost per staff year for the projected workload
- Two main differences between the Cost Model and the RJM
 - states are allowed to request additional funding for “non-personnel services” like IT and communications
 - the states can request additional funding when workloads increase due to unforeseen events

But UI administrative financing still takes no account of a state's performance or quality of service

- And allocations are still paid quarterly, and states are expected to use all their allocations (use it or lose it), so the RJM creates no incentive to economize and innovate

Proposed solutions have focussed solely on technology

- In August, USDOL announced an initiative “to modernize and reform a cornerstone of our economic infrastructure, the unemployment insurance system”
 - Direct technical assistance through tiger teams (multi-disciplinary teams ... of fraud specialists, equity and customer service specialists, UI program specialists, behavioral insights specialists, business intelligence analysts, computer systems engineers, ... and project managers)
 - Tools to address immediate fraud concerns
 - Modernizing antiquated state technology

Ditto legislative proposals

- Sen. Ron Wyden’s “Unemployment Insurance Technology Modernization Act of 2021”
- Would require DOL to “develop, operate, and maintain a modular set of technology capabilities to modernize the delivery of unemployment compensation
- “My bill requires a complete overhaul of unemployment insurance technology, and paves the way for one website to apply for jobless benefits, not 53”

Our point is to reframe the problem as one of information and incentives

- The federal government is the principal, and the states are its agents
- So the role of the federal government is to formulate a mechanism that creates an incentive to provide high-quality administration and low cost

2. Measuring administrative performance

- The Labor Department's main indicator of timeliness is “first payment promptness”
- *Definition:* The % of all first payments counted in a month that were paid within 14/21 days of the week ending date of the first compensable week of the claimant's benefit year
- 21 days for states with a waiting week (most), 14 days for those without
- An odd measure because it is retrospective—when the system is overwhelmed, first payments are delayed, and first payments will be made one or two months after the initial claim

How stringent is this standard?

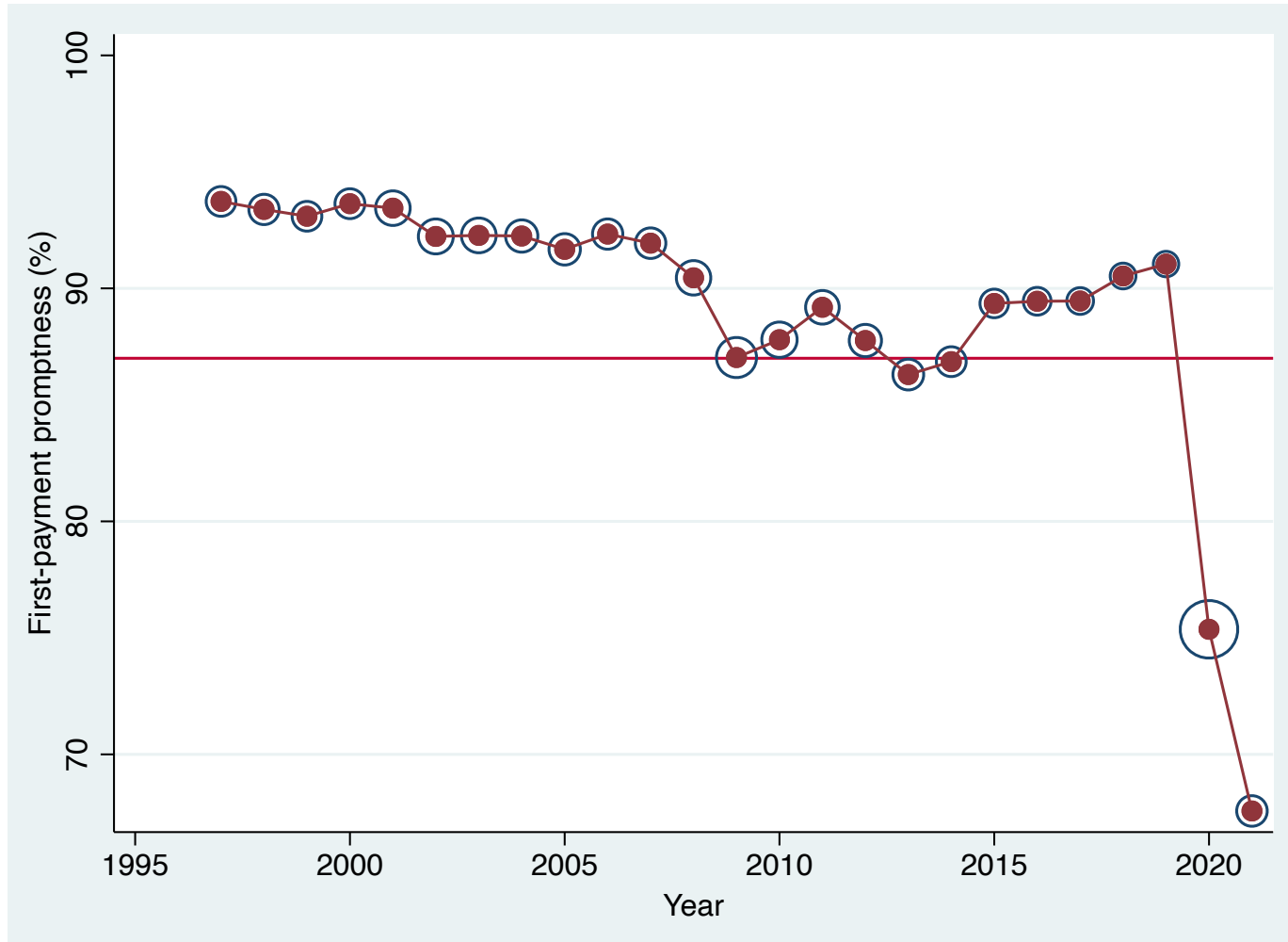
- If you filed a claim online today (**January 9**), the coming week would be the week in which your claim was made
- Your waiting week would be the week of January 16
- Your first compensable week would be the week of January 23, the end of which is January 28
- If your first UI benefit check was mailed or deposited by **February 18** (within 21 days of January 28), it would be considered “prompt” under the DOL’s “Core measures of acceptable performance”

Acceptable level of performance

- DOL has “acceptable levels of performance” for 13 outcomes, including
 - first payment promptness
 - nonmonetary determination time lapse and quality
 - detection of overpayments
 - average age of pending appeals
- For first payment promptness, a state that makes at least 87% of its first payments within 21 days (14 days for states with no waiting week) is performing acceptably

- The following figure shows the percentage of first payments that were “prompt” (within 21 days) for all states (first two figures), and for CA, MA, and MI
- Data from the ETA 9050 report (“Time Lapse of All First Payments except Workshare”)—see *Unemployment Insurance Report Handbook No. 401*, fifth edition. https://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=7774

Annual percentage of 1st payments ≤ 21 days, all states



- *Volume of first payments indicated by size of circle*

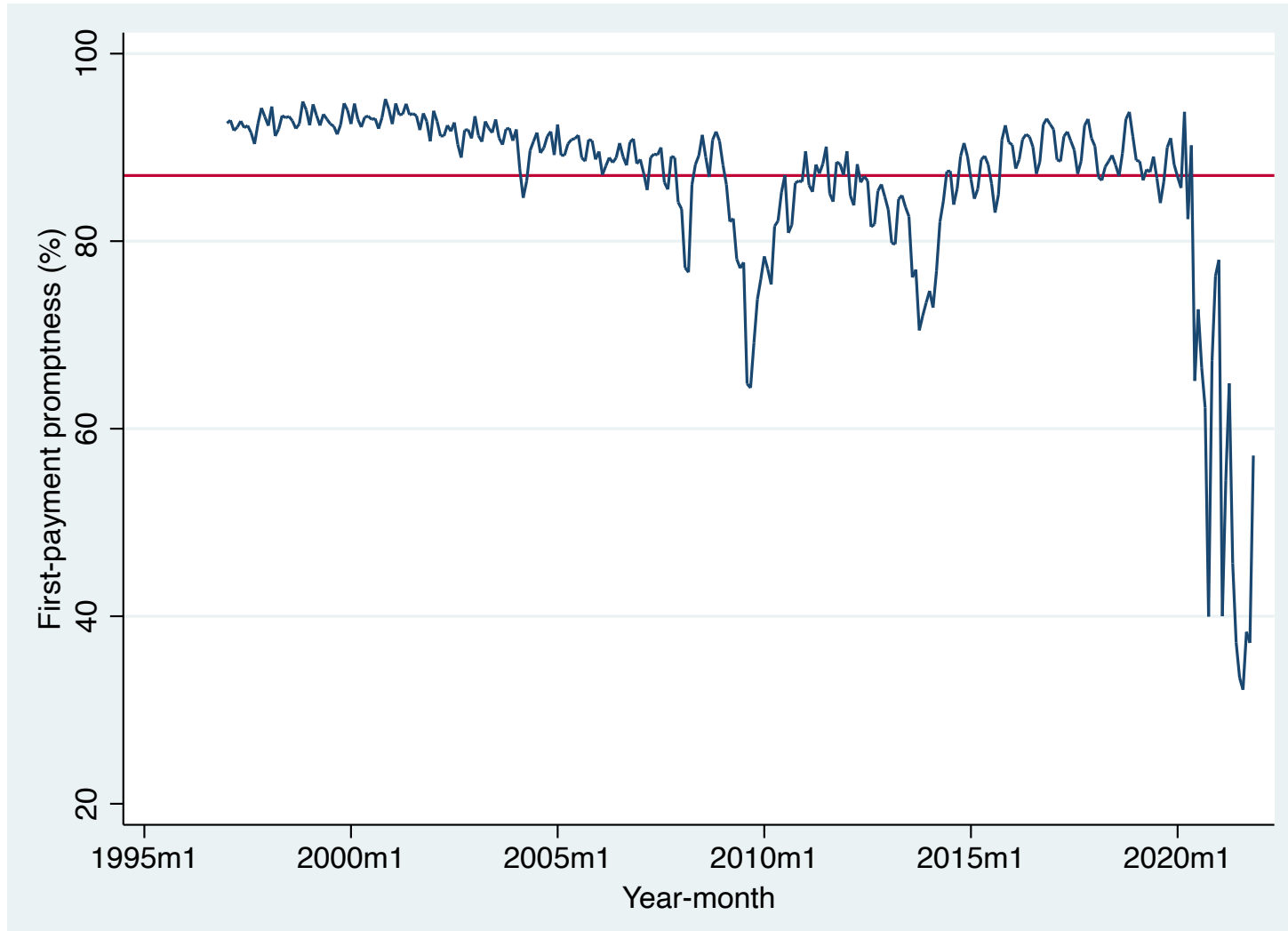
- Apparently, most states usually perform acceptably, but worst performance is during recessions
- And in two of the three long periods that include the last recessions, overall promptness was below the USDOL's standard

First payment “promptness” for three long periods

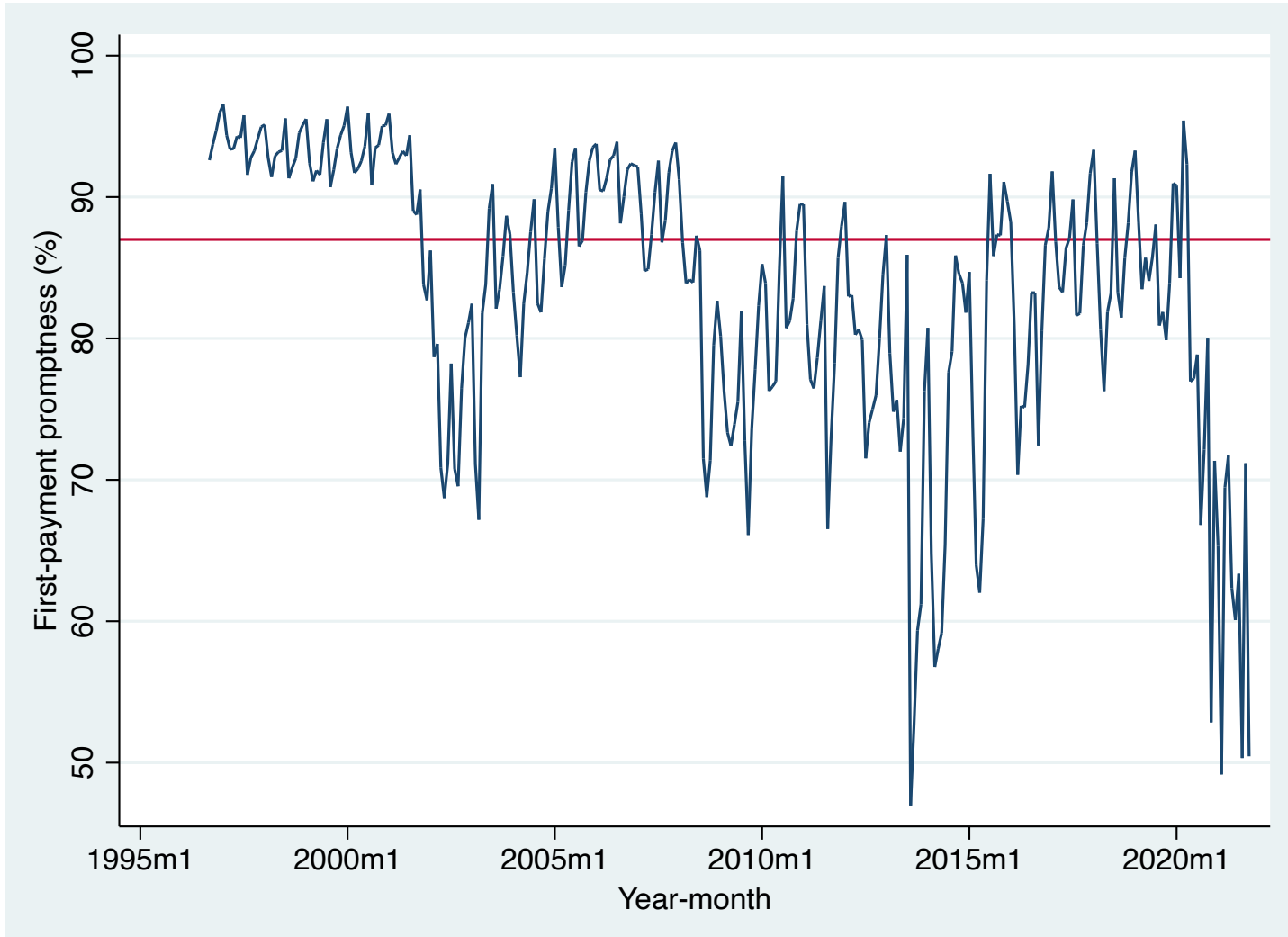
Period (recession during the period)	time lapse \leq 21 days (%)
1997–2004 (Dot-com Recession)	88.9
2005–2012 (Great Recession)	84.2
2013–2021 (Covid Recession)	74.2

- Moreover, some states in particular appear to have problems

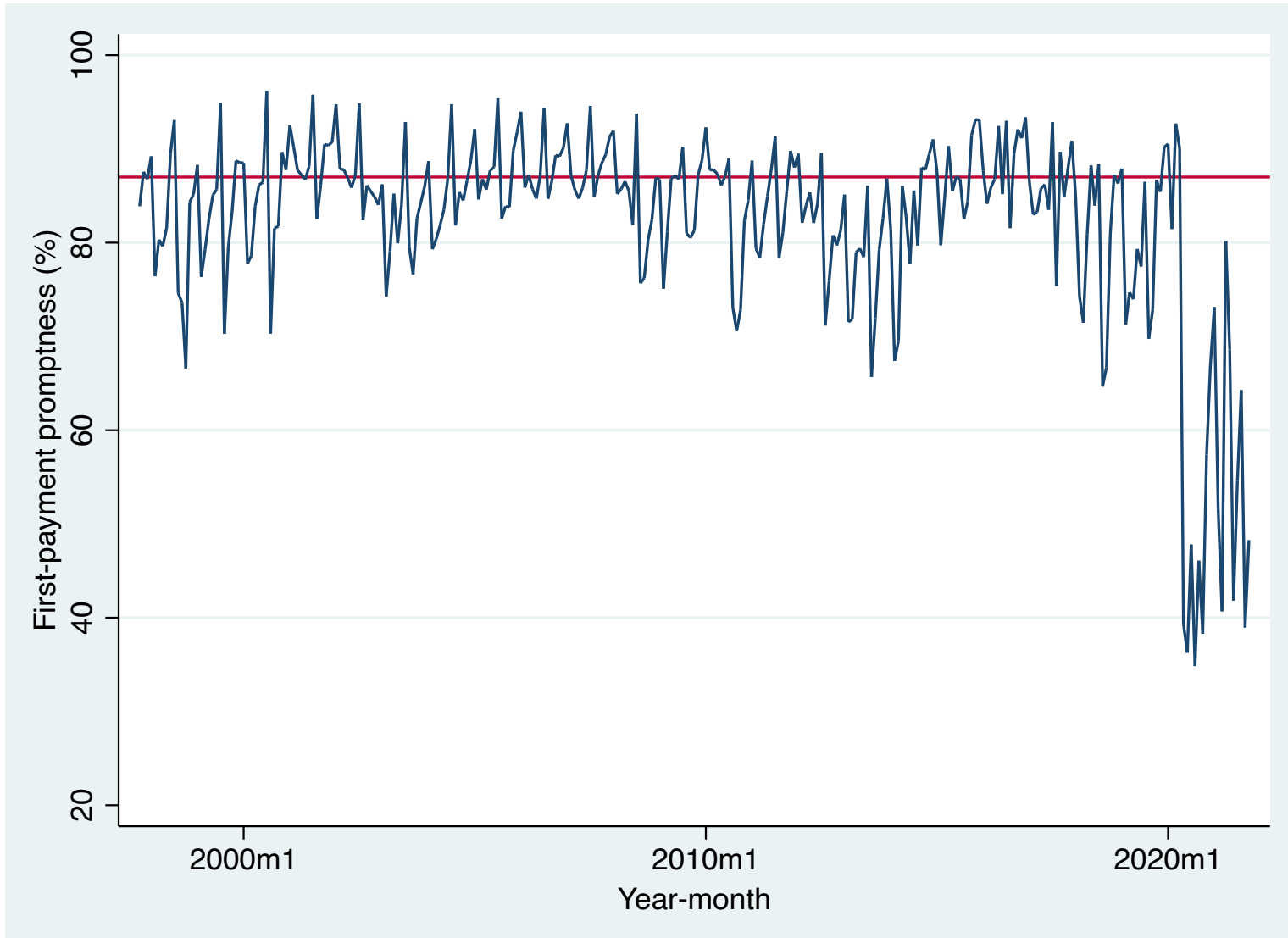
California



Massachusetts



Michigan



3. Promptness and volume of claims

- Some of the variation in promptness should be explained by demand conditions and the volume of claims (or workload)
- How much of the poor performance of some states can be explained in this way?
- Estimate the following regressions over a monthly panel of the 50 states over 1997–2021:
- $promptness_{st} = \beta_1 \log(workload_{st}) + a_s + u_{st}$

where

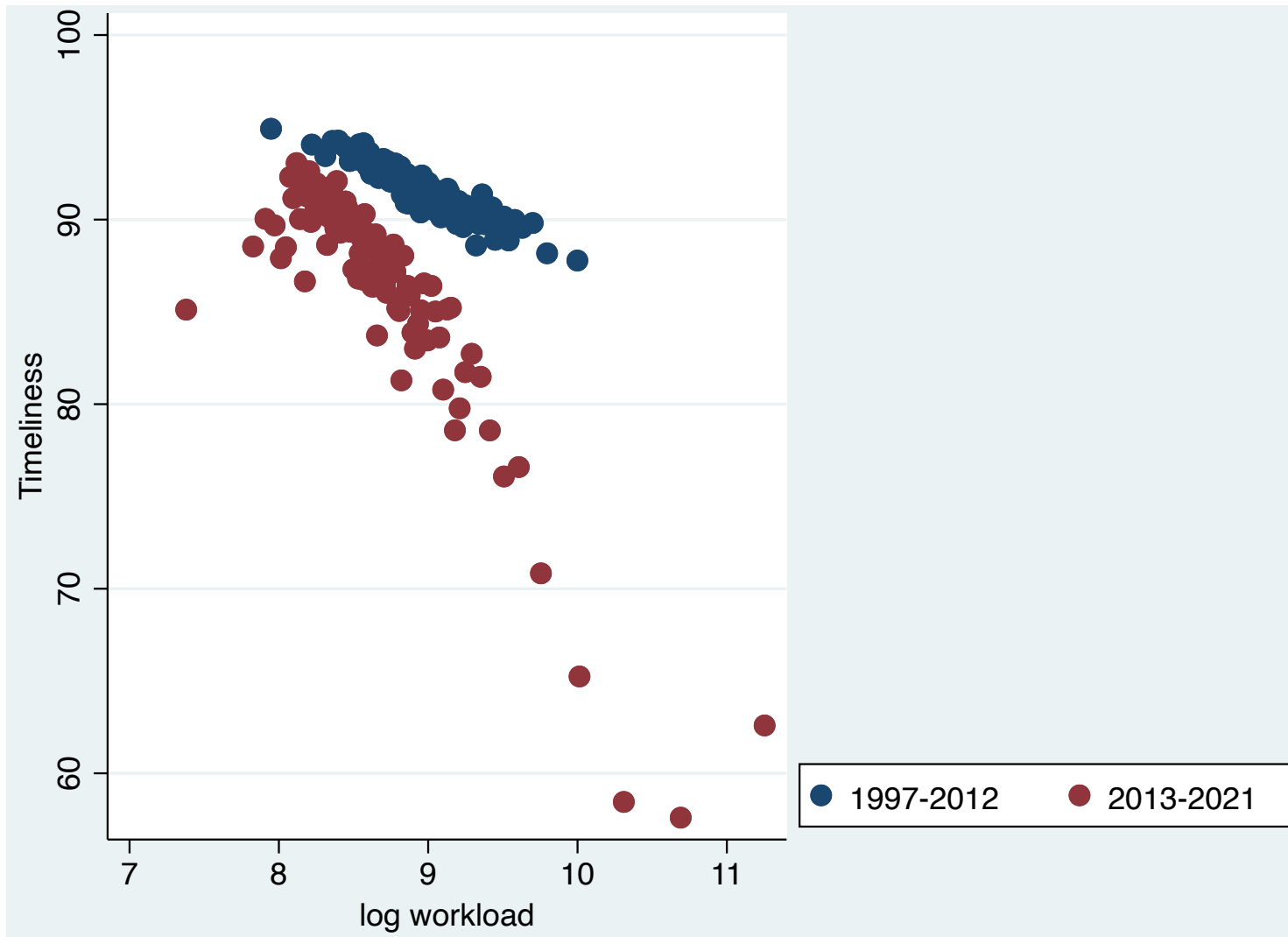
$promptness_{st}$ = % of first payments within 21 days

$workload_{st}$ = one of three measures of claim volume or demand conditions in the state (3-month MA)

a_s = state fixed effects

- This is a rare case where including time effects is not a good idea because they are highly correlated with $workload_{st}$
- The following slide shows two bin-scatters of first-payment promptness ($promptness_{st}$) against $\log(workload_{st})$, after taking out state effects (std. errors clustered on state):
 1997–2012: $promptness_{st} = -3.877 (0.496) \log(workload_{st}) + a_s + u_{st}$
 2013–2021: $promptness_{st} = -10.062 (1.039) \log(workload_{st}) + a_s + u_{st}$

Binscatter of promptness_{st} on $\log(\text{workload}_{st})$



Comparison of *promptness* fixed effects (a_s) with raw (unadjusted) *promptness* fixed effect

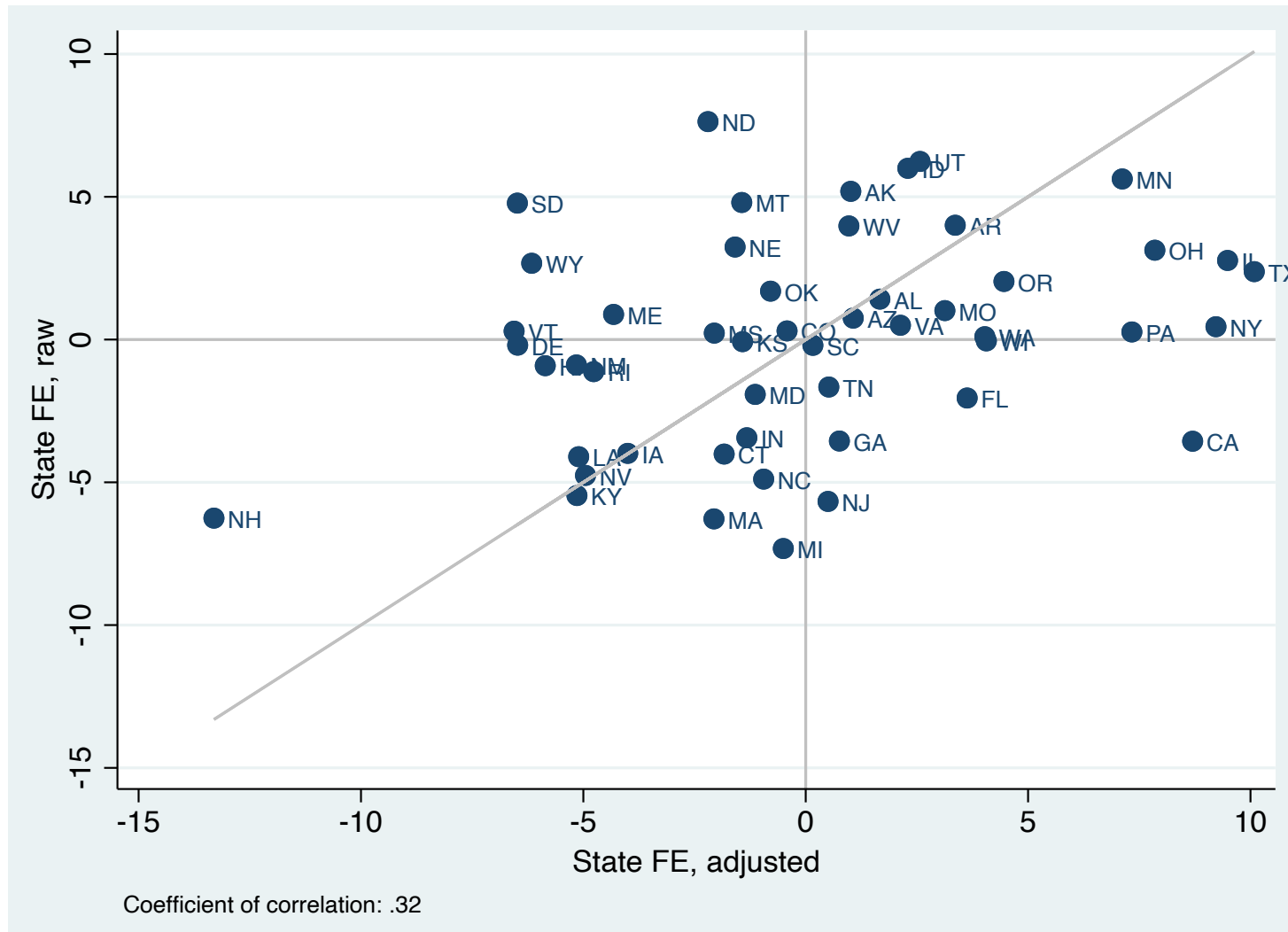
- The figure shows estimated state fixed effects for *promptness* on the x-axis

i.e., a_s from the model that controls for $workload_{st}$:

$$promptness_{st} = \beta_1 \log(workload_{st}) + a_s + u_{st}$$

- Simple unadjusted fixed effects are on the y-axis (from a regression of $promptness_{st}$ on state indicators—so average *promptness* by state)

Unadjusted and adjusted state effects for promptness



Adjusted for workload, some states that appear to be poor performers aren't so bad

- Promptness in MA, MI, NC, NJ is well below average without adjusting for workload, but close to average after adjusting
- CA looks like a great performer after adjusting
- Several small states appear to perform well (unadjusted), but after adjusting, they are only average or below average (AK, MT, NE, ND, SD, WV, WY)
- Suggests scale economies in administering UI and/or advantages of concentrated populations

4. Financing UI administration is a principal-agent problem (Davidson and Martin 1998)

- We argue these problems have resulted from
 - an unsatisfactory mechanism for financing UI administration
 - which has led to underfunded infrastructure and weak administration
- The existing mechanism ignores the principal-agent relationship between the federal government (the principal) and the states (the agents)
- Establishing UI in the 1930s required federal “encouragement” in the form of the SSA because adverse selection and moral hazard held back the states

States' preferences

- States tend to ignore the stabilization benefits of UI and may prefer low benefits so they can keep taxes low
- States may also prefer not to make it “too easy” to access UI because this reduces benefit payouts and keeps costs low
- So there may be little incentive to administer UI efficiently—even if the funding for administration comes from the federal government

Federal role in allocating administrative funding

- Encourage efficient administration (high quality, low cost), including innovation
- Compensate states for circumstances arguably beyond their control (i.e., the “state of nature”)—for example,
 - low population—inability to take advantage of scale economies
 - low density
 - high unemployment
- The feds have the tools—they control the funding and could rescind the FUTA credit for a state that does a poor job of administering UI (although it never has)

The problem is one of information

- Good outcomes depend on both effort and the state of nature, but both are difficult to observe
- Difficult observing effort is clear, but performance can be measured, and the measures already exist
- The state of nature in this case is the technology of producing high quality service at low cost
- Each state's circumstances differ in a variety of ways (as DOL often reminds us) including law and practice, demographics, and industry composition
- How these differences translate into differences in the cost of delivering service is unknown (but modeling could help)

An efficient mechanism (Davidson and Martin 1998)

- Pay for performance—choose shadow prices for different types of performance and pay for meeting targets
 - amounts to monitoring quality and allocating administrative funding to reward high quality
- A residual contract—if the funds paid to the state are not all used, the state keeps the residual
 - creates an incentive to keep costs low (assuming the legislature understands the mechanism)
- Lump-sum payments to states facing high unemployment or other unforeseen circumstances

5. Alternative reforms

We consider four alternatives to pay-for-performance and the residual contract:

- Send in the Feds
- Nationalize UI administration
- Eliminate the federal role
- Contract out (either privately or to other states)

Conclusion: None of these would do a better job than pay-for-performance

Send in the Feds

- This is essentially the “tiger team” approach—assist the states in improving UI administration by improving IT
- It views the problem as technological, and as such it misses the underlying principal-agent problem
- As long as a state’s preferences differ from those of the federal government, there is no guarantee good technology will solve the problem
- Good technology can be used poorly or inefficiently, and the quality of services could remain poor, either by design or by accident

Footnote

- UI Information Technology Support Center (UI ITSC) has existed since 1994 to promote and assist with “development of information technology solutions, modernization of state UI systems, and information sharing among state UI agencies”
- It is a collaboration among NASWA, USDOL, and the state workforce agencies, housed at NASWA since 2009 and funded mainly by grants from the Employment and Training Administration (USDOL)
- NASWA also administers the Workforce Information Technology Support Center (federally funded since 2016) “to implement effective and creative technology solutions”

Nationalize UI administration

- Transfer responsibility for UI administration to the federal government—like Social Security
- This would require a major amendment to the Social Security Act (Section 302), which provides for payments to the states for “the proper and efficient administration” of the UI law
- But more fundamentally, centralizing administration ignores the underlying information problem
- The federal government would still need to collect information on performance and motivate (now federal) agencies in each state to deliver high quality service
- The record of SSDI suggests federal administration would not be a panacea (GAO reports)

Eliminate the federal role

- Give the states responsibility for financing UI administration
- If states naturally prefer lower-cost, lower-quality service, then then this is a recipe for worse performance—more wrongful denials, slower determination of eligibility, longer waits for appeals
- DOL could still monitor performance, but it would have no financial leverage
- It would also lose the ability to give states additional administrative funding when they face high unemployment

Contract out (either privately or to another state)

- This would again require a major amendment to the Social Security Act—the Act specifies that a “State agency” will administer the state’s UI law
- Politically it seems unlikely, and it would still require the federal government to collect performance data
- But it could be a more credible threat than withholding the administrative grant from a state
- Would it be any more effective than pay-for-performance and a residual contract?

6. Summary

- UI administrative financing is central to the effectiveness of UI—delayed payment of benefits impedes the intended consumption smoothing and automatic stabilization benefits of the system
- UI has performed poorly in the past two recessions—not surprising, given the disconnect between performance and funding for administration
- Suggested solutions have ignored economic incentives and the underlying principal-agent problem
- An efficient funding mechanism would include both pay-for-performance and a residual contract