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FOR KIDS, FOR COMMUNITIES, FOR KENTUCKY

A Fiscal and Budget Policy
Research Brief

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Special points of interest:

- Kentucky's unemployment rate has risen from 3.9% in January 2000 to 5.7% in May 2003—a 46 percent increase.
- 2 in 3 unemployed Kentucky workers do not receive unemployment insurance benefits.
- The average weekly unemployment insurance benefit is \$245. The minimum weekly benefit is \$39, the maximum is \$324.



KENTUCKY YOUTH ADVOCATES

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UNEMPLOYMENT INSURANCE IN KENTUCKY: HANGING BY A THREAD

Executive Summary

Unemployment in Kentucky and across the country has risen sharply in the past two years. In Kentucky, more than 112,000 people now find themselves out of work.

Individual workers are not the only ones to feel the strain. Rising unemployment also affects business and government. When individuals and families lose their jobs, people have less money to spend. Consequently, business sales (and profits) tend to decline, potentially creating a further decline in employment. Governments are also impacted by rising unemployment. Lower personal incomes and less business spending mean declining sales and income tax revenues. This forces governments to constrain spending or raise revenues.

To combat the vicious cycle of lower spending—? lower business sales? lower government revenues, unemployment insurance temporarily helps out-of-work people and the economy. Unfortunately, Kentucky's unemployment insurance system provides far less than universal coverage to involuntarily unemployed workers. In fact, only one-third of unemployed Kentuckians receive unemployment insurance benefits. In addition, those unemployed workers who do qualify for benefits receive, on average, \$245 per week.

The economy's steady downturn has prompted many states to revamp their unemployment insurance systems. Kentucky should do the same.

Recommendations:

- 1.) Establish Alternative Base Period.** To begin, Kentucky should adopt an alternative base period—this would permit workers to include their three most recent months of work when determining their eligibility for benefits. The current method excludes these earnings; this is a holdover from an era where eligibility requirements were completed by hand.
- 2.) Grant eligibility to domestic violence victims.** Second, Kentucky should permit victims of domestic violence to be eligible for unemployment insurance benefits when their lives are in jeopardy and continued work is not safe.
- 3.) Eliminate complex income rules.** Third, Kentucky should eliminate its arcane and complicated income eligibility rules. They serve only to exclude workers who would otherwise be eligible for benefits.
- 4.) Include part-time workers.** Finally, unemployment insurance benefits should be extended to part-time workers. The nature of employment today, especially among single-parent workers, increasingly includes part-time work.

Kentucky's unemployment rate has risen more than 46 percent from January 2000 to May 2003.

"Unemployment insurance benefits help limit large cyclical swings in individual, business, and government income."

I. Introduction

Unemployment in Kentucky and across the country has risen sharply in the past several years. (See Chart 1.) As of May 2003, 112,300 Kentuckians were out of work.¹ Only a fraction of those individuals though—about 37,000—received unemployment insurance benefits.²

With Kentucky's unemployment rate rising more than 46 percent from 3.9 percent in January 2000 to 5.7 percent in May 2003, the serious personal consequences are evident. Because bills do not stop when workers lose their jobs, unemployed individuals and families are forced to tap their savings and retirement accounts, seek financial support from family and friends, turn to high-interest credit card debts, drastically cut their spending, or take second and third jobs in order to make ends meet. Unemployment insurance helps alleviate this burden. However, unemployment insurance replaces only, on average, 43 percent of a Kentucky worker's earnings, meaning even for those who receive benefits, the financial support is only modest.

Individuals are not the only ones to face the pinch. Rising unemployment also affects business and government. When individuals and families lose their jobs, business sales decline. This means businesses have lower sale revenues (and profits) and potentially lower employment levels.

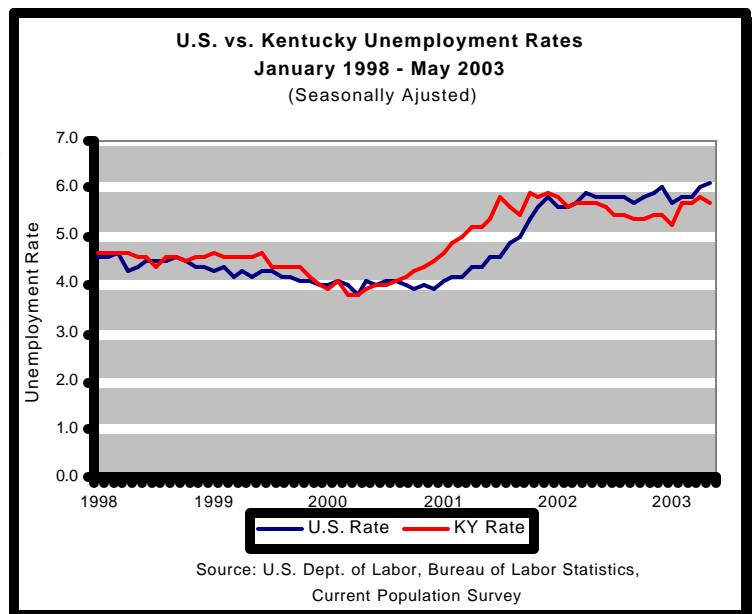
Governments are also impacted by rising unemployment. Lower personal incomes and less business spending

mean declining sales and income tax revenues, among others. This forces governments to constrain spending or raise revenues.

To combat the vicious cycle of Lower consumer spending? Lower business sales? Lower government revenues

unemployment insurance temporarily helps out-of-work people, but also business and government.

Chart 1

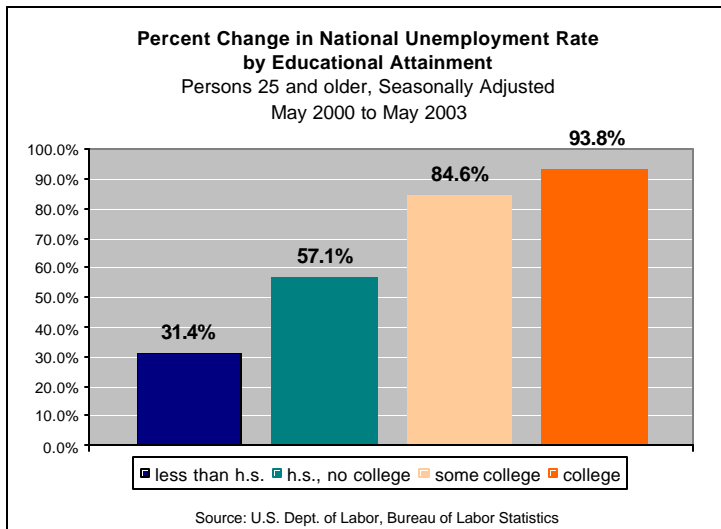


Unemployment insurance benefits help limit large cyclical swings in individual, business, and government income. Unemployed workers who receive weekly unemployment insurance benefits immediately spend that money to pay bills, etc. While these insurance payments do not match a worker's employed weekly earnings, it does help smooth out an individual's consumption pattern by preventing huge swings in spending. The alternative would be much more severe "bust" periods. Similarly, it helps moderate business and government revenue changes.

Unlike previous recessions, this

one has also hit across all educational levels. In fact, unemployment rates for workers with at least some post-secondary education have risen faster than for workers with a high school education or less.³ (See Chart 2.)

Chart 2



II. Eligibility

Kentucky uses a complex method to determine who is and who is not eligible for unemployment insurance benefits. Not every unemployed person is eligible for benefits.

In addition to strict earnings guidelines, an unemployed worker must have been working for a certain period of time, be seeking full-time employment, and lost their job through no fault of their own.

To be eligible for unemployment insurance benefits a person must pass each of the following tests:

1. earn at least \$750 in the first four of the last five completed calendar quarters;
2. earn at least 1.5 times their highest quarter earnings; and
3. earn at least eight times their weekly benefit amount.

While these earning amounts may not look particularly high, they do create significant eligibility barriers. For example, consider a woman employed as a construction worker. She may have most of her earnings from June to August, the warm summer months, and then

earn smaller amounts in the other eight months. Assume she earns at least \$750 in each of four consecutive quarters. That means she passes the first eligibility test.

The second eligibility test is the requirement that she earn at least one and a half times her highest quarterly earnings over the four-quarter base period. Because her earnings may have been significantly less in the non-summer

months when construction activity tails off, she may not qualify for unemployment insurance benefits.

Here’s an example. Assume this construction worker has her highest quarterly earnings in Quarter 3—the summer months. From June thru August she earned \$20,000. The previous six months—Quarters 1 and 2—and the following three months—Quarter 4—she only earned \$3,000 in each quarter. Her total earnings, therefore, were \$29,000. (See Chart 3 below.)

Under existing Kentucky law, she easily passes the first earnings eligibility test—earning at least \$750 in each quarter. However, she fails the second test—earning at least 1.5 times her highest quarter. Because she earned \$20,000 in Quarter 3, her four-quarter earnings total must equal or exceed \$30,000 (\$20,000 X 1.5). Her total, though, was \$29,000. Consequently she would be ineligible for unemployment insurance

To be eligible for unemployment insurance benefits, a workers has to meet complicated earnings requirements.

Chart 3

Example					
Determining Earning Eligibility: Not Everyone Will Qualify					
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total
Earnings	\$3,000	\$3,000	\$20,000	\$3,000	\$29,000
Requirement #1: \$750 earnings each quarter PASSED					
Requirement #2: 1.5 times highest quarter FAILED (Total earnings must meet or exceed 1.5 X \$20,000, which is \$30,000; actual earnings total \$29,000.)					

benefits.

In this particular scenario, the final requirement—eight times her weekly benefit amount—is irrelevant. However, if she did have total earnings 1.5 times her highest quarter, then she would have passed this requirement.

According to the National Employment Law Project, Kentucky places one of the ten highest earnings thresholds on workers seeking unemployment compensation.

III. Reciprocity

Not every unemployed person is eligible for unemployment insurance benefits. To receive benefits, an unemployed worker must meet earnings and other requirements as described previously. Consequently, only about one-third of unemployed persons in Kentucky receive unemployment insurance benefits.⁴ Compared to Kentucky's neighboring states, this is the lowest "reciprocity" rate.⁵ (See Chart 4.)

The reason for such a low number of unemployed persons actually receiving unemployment insurance benefits is simple—strict earnings requirements. As the previous section noted, Ken-

tucky has one of the ten most restrictive earnings requirements of any state. Consequently, many unemployed workers, like the construction worker in the example, may be ineligible for benefits.

Another reason is the earnings period. Kentucky's unemployment insurance system requires that a person have earnings in the first four of the last five calendar quarters. The last quarter of work is excluded. That can make it difficult for new entrants to the labor force to become eligible for unemployment insurance. Here's what that means.

Assume it's January 1, 2003, and you were just laid-off. In order to be eligible for unemployment insurance you would need to have earnings between October 2001 and September 2002—the first four of the last five completed quarters. Your last quarter of work, October 2002 thru December 2002, does not factor into your eligibility equation. Diagrammatically, it would look like Chart 5 (see next page).

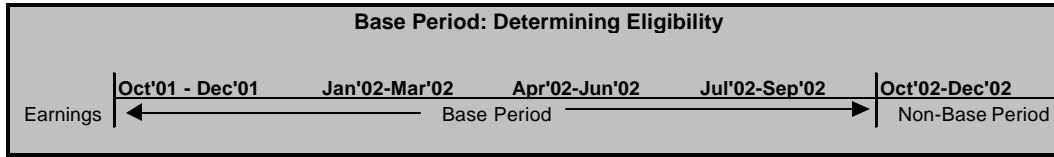
By not allowing the last quarter's worth of work into the eligibility equation, many people fail the earnings eligibility test. This particularly affects people new to the labor market, including former welfare recipients. From numerous studies, we know that welfare reform (and the booming 1990's economy) led to an incredible rise in the number of new workers.⁶ Single-parent mothers on welfare, specifically, saw their unemployment rates plummet.⁷ This pool of "new" labor market entrants dramatically changed the employment landscape. Many people began developing their

In Kentucky, only about one-third of unemployed persons receive unemployment insurance benefits.

Chart 4

State	Reciprocity Rate
Illinois	44%
Indiana	41%
Kentucky	34%
Missouri	40%
Ohio	45%
Tennessee	48%
Virginia	36%
West Virginia	38%
U.S. Average	45%

Chart 5



first employment records. Unfortunately, one of these former welfare recipients, for example, who finds a job will have to wait at least fifteen months (five quarters) before they become eligible for unemployment insurance benefits in Kentucky.

IV. Benefits

For those Kentucky workers that do qualify for unemployment insurance, the average unemployment benefit for January 2003, the latest for which information is available, is \$245 per week.⁸ The maximum weekly benefit is \$324. The state’s average weekly wage for people covered by unemployment insurance is 576.^{9,10}

In percentage terms, Kentucky’s unemployment insurance benefit replaces 43.4 percent of a worker’s average weekly wage. Neighboring states and the nation as a whole has lower replacement rates.¹¹ (See Chart 6.) Unemployment insurance benefits in Kentucky are, by neighboring states’ standards, fairly supportive.

State	Replacement Rate
Illinois	36.9%
Indiana	41.6%
Kentucky	43.4%
Missouri	33.8%
Ohio	39.9%
Tennessee	35.4%
Virginia	39.4%

The maximum number of weeks that an unemployed person may receive benefits in Kentucky is twenty-six. The total number of weeks depends upon several factors, including an individual’s

base period earnings. Federal unemployment changes have provided additional weeks of coverage, but do not include all unemployed workers.¹²

V. Who Pays for Unemployment Insurance Benefits?

Employers remit an unemployment insurance tax to the federal government, but workers typically bear the tax burden. Here’s how the system works.

On the employer side, the amount of tax the employer pays depends predominately upon two factors—the number of people from their business that received unemployment insurance benefits in the past and the size of their unemployment insurance account balance.

Businesses with a history of unemployment insurance claims pay higher tax rates, all other things constant, than business with fewer claims. The tax rates range from 0.3 percent to 9.0 percent in Kentucky.¹³

Only the first \$8,000 of worker wages in Kentucky is taxed, though. For example, if a worker earns \$30,000 a year, an employer only collects and remits the state unemployment insurance tax on the first \$8,000 of earnings. Across the country, states collect the unemployment insurance tax on earnings up to \$9,500.¹⁴

Although employers collect and remit the unemployment insurance tax to the government, they do not necessarily bear that tax burden—workers do. Part of the reason is that employers cannot evade this tax by moving from one state

How are unemployment insurance benefits calculated?

Weekly benefits in Kentucky are based upon an employee’s wages. Total base period wages are multiplied by a benefit factor (current statute is 1.3078 percent) to obtain the weekly benefit amount. The minimum weekly benefit in is \$39. The maximum is \$324.

“While unemployment insurance benefits clearly alleviate short-term earning losses for individuals and families, they also provide positive effects for businesses.”

to another. Every state has a state unemployment insurance tax. That essentially eliminates any interstate competitive advantages that might arise from one state charging a tax and another not.¹⁵ Also, the federal government requires every state to collect unemployment insurance taxes on at least the first \$7,000 in worker earnings. Kentucky collects taxes on a slightly higher amount, \$8,000.

Employers recognize that the unemployment insurance tax is one of the costs of business in every state. Consequently, they have three methods of paying this tax: 1) raise product prices, thereby forcing the unemployment insurance cost on buyers of their goods and services; 2) lower employee wages by the amount of the tax; or 3) reduce business profits. In the first two situations, workers bear the tax burden.

While unemployment insurance benefits clearly alleviate short-term earning losses for individuals and families, they also provide positive effects for businesses. Here’s how. When workers receive unemployment insurance benefits they spend that money. In turn, that spending helps sustain business sales. This system of unemployment insurance helps smooth the valleys created by recession and high unemployment rates and raises everyone’s well being.

VI. Prescriptions for These Tough Economic Times

The nation’s steady economic downturn has prompted many states to revamp their unemployment insurance systems. For instance, Georgia and Oklahoma recently relaxed rigid eligibility requirements or have undertaken other improvements to their state’s unemployment insurance system. Kentucky should consider doing the same. Here are four recommendations to improve Kentucky’s unemployment insurance system.

A. Implement Alternative Base Period

An alternative base period would permit workers with shorter work histories or more recent earnings growth to be eligible for unemployment insurance benefits. This would most likely help people who recently transitioned from welfare-to-work or just entered the job market after completing high school, trade school, or college.

Here’s how it would work. Eligibility would first be calculated under existing Kentucky law. That is, a worker’s earnings during the first four of the last five quarters would be determined. If those earnings are sufficient to make that worker eligible for unemployment insurance benefits, then no other steps are needed. If, however, the worker does not qualify under that method, then the most recent quarter would be added. Including a worker’s most recent quarter of earnings to determine unemployment insurance eligibility is called the “alternative base period.”

Presently, sixteen states have an alternative base period. This includes Ohio, Oklahoma, and Georgia.¹⁶

According to the National Employment Law Project, adopting an alternative base period would increase unemployment insurance claims by 4 to 7 percent. With more than 100,000 Kentuckians currently out of work, that would mean an additional 4,000 to 7,000 people would receive unemployment insurance benefits. Based upon experiences in other states, implementing an alternative base period would raise total unemployment insurance expenses by 4 to 6 percent. With nearly \$500 million in benefits paid during 2002, this would mean an additional \$20 to \$24 million in benefits payments.

B. Include Domestic Violence Victims

Victims of domestic violence who leave work for personal safety or emotional reasons are ineligible for unemployment insurance benefits. Individuals confronted by such strife should receive unemployment insurance benefits.

This proposal carries a minimal cost. Estimates from the National Employment Law Project place the annual cost at several hundred thousand dollars a year.

C. Eliminate Complex Earnings Requirements

Kentucky's earning requirements are extraordinarily complex. A person needs to meet three different earnings requirements in order to be eligible for unemployment insurance benefits. This method of determining eligibility excludes certain types of workers from the unemployment insurance system. Recent entrants to the labor market are hurt the most. To make the system fair for all Kentuckians, earnings requirements should be simple and consistent. A single earnings eligibility requirement would improve the system. For example, eligibility could be simplified by only requiring that a person earn at least \$2,000 in four consecutive quarters.

The cost of simplifying Kentucky's earnings requirements is unclear. It will depend upon several factors, including whether an alternative base period is implemented and the earnings levels for the new earnings requirements set.

D. Include Part-Time Workers

More and more Kentuckians are employed part-time. Nationwide, almost 17 percent of the labor force works part-

time.¹⁷ Nearly one-sixth of those working part-time did so involuntarily.¹⁸ That is, they preferred to work full-time but could only find part-time employment. The reasons are numerous. They include: the lack of full-time jobs; the need to supplement full-time wages; and the need to care for a child, elderly parent, or spouse. Because Kentucky's unemployment insurance system currently requires workers to seek full-time employment to be eligible for benefits, part-time workers are excluded from the system.

Twenty-four other states currently make unemployment insurance benefits available, on some basis, to part-time workers.¹⁹ This includes Illinois, Arkansas, and Florida.

Including part-time workers in the unemployment insurance system would cost tens of millions of dollars, or more, each year. An exact figure will depend upon the number of part-time workers and whether they have to meet existing or revised earnings requirements.

VII. How to Pay for Improvements

Several options for funding these improvements to Kentucky's unemployment insurance system exist. In order of preference they are: tap \$100 million in Reed Act dollars; raise the unemployment insurance tax base to the national average; dip into the state's trust fund.

First, Kentucky's unemployment insurance system unexpectedly received \$100 million from the federal government in April 2002. These dollars now provide a readily available source of funds to help thousands of families be eligible for unemployment insurance benefits.

Second, Kentucky's unemploy-

Improvements to Kentucky's unemployment insurance system can be funded by using \$100 million in federal funds, raising the unemployment insurance tax base, or tapping the existing \$500 million trust fund balance.

ment insurance tax base is \$1,500 below the national average. While wages have grown in recent years, the taxable wage base has not.²⁰ Because unemployment insurance benefits are based, in part, on earnings, unemployment insurance benefits are growing while the taxable wage is not.

Third, Kentucky's unemployment insurance system also maintains a trust fund balance of \$567 million.²¹ While a larger reserve would be preferred, given the state's flailing economic health, now is an appropriate time to tap some of these resources. Doing so can help moderate this economic downturn. The state's unemployment trust fund balance is sufficient to meet all

benefit claims for about six months even if all unemployment insurance tax payments stop.²²

VIII. Conclusions

Unemployment in Kentucky has risen sharply in the past several years. As of May 2003, 112,300 Kentuckians were out of work. Despite relatively generous unemployment insurance benefits in Kentucky compared to neighboring states, only one-third of unemployed workers receive these benefits. Given the continued economic difficulties in Kentucky, now is an appropriate time to improve the state's unemployment insurance system. Doing so will provide positive returns not only for individuals, but businesses and government as well.

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Highlights

- ? Unemployment in Kentucky has risen 46 percent in the past several years.
- ? As of May 2003, 112,300 Kentuckians were out of work.
- ? Only one-third of unemployed workers receive unemployment insurance benefits.
- ? Part-time workers, victims of domestic violence, people transitioning from welfare to work, and new high school and college graduates are excluded from the unemployment insurance system.

Recommendations:

- ? Establish an alternative base period—this would allow people to count their work activity for the most recent three month period.
- ? Grant unemployment insurance eligibility to domestic violence victims.
- ? Eliminate complex income rules.
- ? Include part-time workers as eligible unemployment insurance beneficiaries.