



## The Ins and Outs of Unemployment Insurance

November 2010

*"The passage of the Social Security Act in 1935 created a lifeline for workers who lose jobs through no fault of their own."*  
—Secretary of Labor Hilda Solis, August 11, 2010

After months of debate in Congress, on July 22, 2010, President Obama signed [legislation](#) extending the unemployment insurance benefit period for 2.5 million Americans.<sup>1</sup> Although economists generally agree that income support, such as unemployment benefits, helps stabilize the economy during difficult economic times, they debate whether long benefit periods keep the unemployment rate artificially high by discouraging workers from searching for jobs and/or accepting unattractive jobs.<sup>2</sup> Understanding the unemployment insurance system and why economic theory is involved helps explain the debate.

Created in 1935 as part of the Social Security Act, unemployment insurance is intended to assist those who lose a job. To be eligible, recipients must (i) be unemployed, (ii) have not quit or been fired for cause from their last job, and (iii) be actively looking for work. During spring 2010, nearly 11.4 million people met these qualifications and collected benefits.

States typically provide 26 weeks of unemployment benefits, funded by a payroll tax; some states offer benefits for longer periods. During periods of high national [long-term unemployment](#), when increases in job losses and/or decreases in job openings result in a shortage of job opportunities, the benefit period is often extended nationwide. Federal payroll taxes typically fund half the cost of such extended benefits. Because of the subdued economic recovery from the 2007-09 recession, Congress has modified the unemployment insurance system five times in the past three years and in 2009 the federal government assumed responsibility for *all* benefits beyond 26 weeks. In states with the highest unemployment, the program has been extended to 99 weeks.

Individual benefits depend on a person's previous pay. Generally, payments are 50 percent of previous earnings, up to a maximum amount. For example, Maryland's cap is \$410/week and Virginia's \$378/week.<sup>3</sup>

To analyze the trade-offs associated with longer benefit periods, it is necessary to understand *opportunity cost*. Opportunity cost is the highest-valued alternative that must be forgone to pursue a particular activity. For example, an individual who chooses to take a job before his or her unemployment benefits expire decides that the value of the new job now is greater than the additional cost of searching for a better job. The opposite could also be true: The individual could decide that the value of the new job is less than the unemployment benefits received. Put simply, unemployment insurance increases the unemployment rate by making unemployment tolerable for some people. Economists disagree, however, on the magnitude of the problem: Some suggest that extending the benefit period beyond 26 weeks results in a relatively small (0.4 percent) increase in the unemployment rate; others estimate a more dramatic (2.7 percent) effect.<sup>4,5</sup> Regardless, the program does achieve its implicit goal—providing financial support to jobless workers facing economic uncertainty and immediate costs.<sup>6</sup> In addition, unemployment insurance may allow more-efficient matching of workers with appropriate jobs by allowing workers to look for jobs better suited to their tastes and skills or time for job retraining. Although the implications of extended benefit periods often stir debate, economists generally agree that 99 weeks of unemployment insurance is not optimal during normal times.

—By Hoda El-Ghazaly, Research Associate

<sup>1</sup> *Los Angeles Times*, "[Obama Signs Extension of Unemployment Benefits](#)," July 22, 2010. The bill extends (i) benefits (retroactively and going forward) to those whose benefits had expired and (ii) the application deadline to November 30, 2010. The bill does not extend benefits past the existing 99-week maximum.

<sup>2</sup> Since December 2007, 7.6 million jobs have been lost. Although the economy is rebounding, the unemployment rate still remains high and private sector job gains are relatively weak compared with previous recoveries.

<sup>3</sup> Fletcher, Michael and Hedgpeth, Dana. "[Are Unemployment Benefits No Longer Temporary?](#)" *Washington Post*, March 9, 2010.

<sup>4</sup> Valletta, Rob and Kuang, Katherine. "[Extended Unemployment and UI Benefits](#)." Federal Reserve Bank of San Francisco *Economic Letter*, 2010-12, April 19, 2010.

<sup>5</sup> Barro, Robert. "[The Folly of Subsidizing Unemployment](#)." *Wall Street Journal*, August 30, 2010.

<sup>6</sup> European countries have struggled with high unemployment rates over the past 30 years. How labor-market institutions and the social protections they offer affect the unemployment rate remains a topic of discussion. See Blanchard, Olivier J. "[Explaining European Unemployment](#)." National Bureau of Economic Research, Summer 2004.

*The views expressed are those of the author and do not necessarily reflect the official positions of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or the Board of Governors.*

## Additional Articles on Unemployment Insurance

[“The Case for and Against Unemployment Insurance”](#) by Derek Thompson, *Atlantic*, July 20, 2010.

Provides a thorough overview of the topics that make unemployment insurance controversial.

[“Long-term Unemployment Experience of the Jobless,”](#) by Randy Ilg, U.S. Bureau of Labor Statistics *Issues in Labor Statistics*, June 2010.

Evaluates the trends in long-term unemployment, especially as related to younger workers.

[“A Historical Look at the Labor Market During Recessions,”](#) by Enrique Martinez-Garcia and Janet Koech, Federal Reserve Bank of Dallas *Economic Letter*, January 2010.

Compares the labor-market impact of the current recession with previous economic downturns, including the Great Depression.

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## Free Data Sources and Reports

**Resource:** Unemployment insurance facts  
**Description:** Links to information about unemployment insurance benefits: eligibility, extended benefits, claims, etc.  
**Published by:** U.S. Department of Labor  
**Location:** <http://www.dol.gov/dol/topic/unemployment-insurance/>

**Resource:** Job Openings and Labor Turnover Survey  
**Description:** Comprehensive monthly data and charts on job openings, hires, and separations.  
**Published by:** Bureau of Labor Statistics  
**Location:** <http://www.bls.gov/jlt/>

**Resource:** Unemployment data  
**Description:** Links to national and state/local unemployment data, as well as layoff statistics.  
**Published by:** Bureau of Labor Statistics  
**Location:** <http://www.bls.gov/bls/proghome.htm#unemployment>

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