


1999

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Sachin Pandya

*University of Connecticut School of Law*

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## Recommended Citation

Pandya, Sachin, "Retrofitting Unemployment Insurance to Cover Temporary Workers" (1999). *Faculty Articles and Papers*. 78.  
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Citation: 17 Yale L. & Pol'y Rev. 907 1998-1999



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# Retrofitting Unemployment Insurance To Cover Temporary Workers

Sachin S. Pandya<sup>†</sup>

In 1935, Congress passed the Social Security Act<sup>1</sup> and created the unemployment insurance (“UI”) system. Although the state administer UI programs in different ways, the early state UI laws usually included a version of the Social Security Board’s “declaration of policy”:

Economic insecurity due to unemployment is a serious menace to the health, morals, and welfare of the people of this state. Involuntary unemployment is therefore a subject of general interest and concern which requires appropriate action by the legislature to prevent its spread and to lighten its burden which now so often falls with crushing force upon the unemployed worker and his family. The achievement of social security requires protection against this greatest hazard of our economic life. This can be provided by encouraging employers to provide more stable employment and by the systemic accumulation of funds during periods of employment to provide benefits for

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<sup>†</sup> B.A., University of California at Berkeley, 1993; M.A., Columbia University, 1995; J.D., Yale Law School, 1999. The author is grateful to Professor Jerry Mashaw, who read several drafts of this Note and offered detailed and enormously helpful comments.

1. Ch. 53, 49 Stat. 620 (1935) (Titles III & IX). Under the Federal Unemployment Tax Act (“FUTA”), 26 U.S.C. §§ 3301-3311 (1994), Congress imposes a federal payroll tax on all employers, but credits employers for taxes paid under a state unemployment insurance system so long as that system meets minimum federal standards. This tax-offset scheme encourages each state to adopt an unemployment insurance system with a largely uniform design across states but allows each state to vary its program in the details. Although many favored a single national system, Congress adopted this decentralized state-based UI system because it feared that the Supreme Court would find a national system unconstitutional, as it had other early New Deal legislation. *See, e.g., A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935) (invalidating early New Deal legislation as an unconstitutional exercise of the federal Commerce Clause power). Several years earlier, however, the Court had upheld a federal estate tax scheme that imposed a tax on all states but remitted credits if the state itself passed an estate tax. *See Florida v. Mellon*, 273 U.S. 12 (1927). Therefore, UI’s founders, at Justice Louis Brandeis’s suggestion, adopted and implemented a similar tax-offset scheme, which successfully survived Supreme Court review. *See Steward Machine Co. v. Davis*, 301 U.S. 548 (1937). Although the constitutional law regime that would have threatened a national UI system did not survive the New Deal, the structure of the UI system still reflects the legal realities of an earlier time. *See KATHERINE BAICKER ET AL., A DISTINCTIVE SYSTEM: ORIGINS AND IMPACT OF U.S. UNEMPLOYMENT COMPENSATION 14-17* (National Bureau of Econ. Research Working Paper No. 5889, 1997).

periods of unemployment, thus maintaining purchasing power and limiting the serious social consequences of poor relief assistance.

Over half a century later, UI's basic goals have not changed—provide significant temporary relief to persons suffering from involuntary unemployment<sup>3</sup> and stabilize employment<sup>4</sup>. At the same time, however, the plight of temporary workers illustrates that UI has failed to keep pace with fundamental changes in the labor market. Temporary workers constitute one of the fastest growing segments of the workforce.<sup>5</sup> They also suffer disproportionately more unemployment than other kinds of workers in the labor force,<sup>6</sup> primarily because, by definition, temporary work ends after a fixed term expires or after the worker completes a discrete work assignment. Temporary workers have no contract for ongoing employment beyond the discrete time period or assignment. Thus, even if a temporary worker wants to continue working, the very nature of temporary work *guarantees* that he or she will be unemployed.

Nevertheless, UI does not cover most temporary workers, because its mechanisms for curbing moral hazard are too antiquated. The moral hazard problem is “[t]he tendency of an insured [person] to relax his efforts to prevent the occurrence of risk that he has insured against because he has shifted all or part of the expected cost of the risk . . . .”<sup>7</sup> UI faces two versions of the moral hazard problem. In the *claimant*-side moral hazard problem, individuals decide not to work, thereby shifting the cost of unemployment onto UI. To avoid this problem, UI typically limits the duration and level of benefits, sets minimum earnings requirements, restricts coverage to only those unemployed persons who become unemployed involuntarily, and requires that recipients actively look for work and accept suitable work. These mechanisms to mitigate moral hazard, however, disproportionately exclude temporary workers from UI coverage, because most states set the earnings minimums too high, treat tem-

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2. SAUL J. BLAUSTEIN, UNEMPLOYMENT INSURANCE IN THE UNITED STATES: THE FIRST HALF CENTURY 46 (1993) (quoting Social Security Board, Draft Bills for State Unemployment Compensation of Pooled Funds or Employer Reserve Account Types 1 (1936)).

3. For evidence that UI provides significant temporary relief, see Jonathan Gruber, *The Consumption Smoothing Benefits of Unemployment Insurance*, 87 AM. ECON. REV. 192 (1997).

4. See BLAUSTEIN, *supra* note 2 at 56-57; see also *infra* Part III.

5. See Angela Clinton, *Flexible Labor: Restructuring the American Work Force*, MONTHLY LAB. REV., Aug. 1997, at 3, 4 (finding that “[h]elp supply services”—a category that includes temporary help services—“was the most rapidly expanding industry in both business services and engineering and management services between 1972 and 1996”).

6. See WAYNE VROMAN, U.S. DEP'T OF LABOR, LABOR MARKET CHANGES AND UNEMPLOYMENT INSURANCE BENEFIT AVAILABILITY 22 (Unemployment Ins. Occasional Paper 98-3, 1998).

7. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 108 (4th ed. 1992). For a critical history of the “moral hazard” concept, see Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996).

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porary workers who complete their jobs as if they had left those jobs voluntarily, and do not allow temporary workers with a past history of temporary work to refuse subsequent offers of temporary work without losing their benefits.<sup>8</sup> Together, these eligibility rules undermine UI's ability to meet its goal of providing relief to a segment of the population suffering from unemployment.

Similarly, in the *employer-side* moral hazard problem, employers shift their labor costs onto UI by laying off workers temporarily during slumps in consumer demand, intending to rehire them when business improves rather than pay to keep them on the payroll. To discourage this practice, UI practices "experience-rating": that is, it charges an employer additional taxes for each former employee who receives UI benefits.<sup>9</sup> Even if temporary workers somehow qualify for UI benefits, temporary help agencies, which provide temporary workers to clients, often try to avoid experience-rating by arguing that their clients, not they themselves, are the real "employers" for the purposes of UI tax liability. Furthermore, both the agencies and their clients can avoid the additional tax liability that accompanies experience-rating by misclassifying their temporary workers as independent contractors. Together, these tax avoidance strategies undermine experience-rating's capacity to stabilize employment.

This Note explains how UI excludes temporary workers and shows how legislatures can retrofit their state UI systems to cover them. In the process, the Note shows how to advance more effectively UI's goals of temporarily assisting the unemployed and stabilizing aggregate employment. In particular, this Note proposes that legislatures: (1) calculate monetary eligibility by counting most recent wages earned, (2) lower minimum earnings requirements by considering hours worked as well as wages, (3) refuse to treat a worker who completes a temporary job as if he or she had voluntarily quit, (4) allow temporary workers receiving UI benefits to refuse offers of temporary work even if they have a past work history of temporary work, and (5) ensure effective experience-rating of employers that hire temporary help workers by imposing joint tax liability on both temporary help agencies and their clients and eliminating low-wage and short-duration exemptions to experience-rating.

To correct for any moral hazard that may emerge from these proposals, this Note proposes ways of curbing benefit eligibility that reward only those temporary workers *who use UI benefits to look for permanent work*. UI's moral hazard rules should be designed to distinguish between

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8. *See infra* Part II.

9. Only America imposes experience-rating of this kind. *See* BAICKER ET AL., *supra* note 1, at 1.

workers who prefer permanent work and those who do not. By extending eligibility to temporary workers who prefer permanent work, UI not only can provide those workers with temporary monetary relief, but also can enable them to use their unemployment spell to escape the temporary workforce, thereby, in the long run, stabilizing overall employment by reducing the number of temporary workers.

In the face of changes in the labor market that Congress could not have anticipated over half a century ago, retrofitting UI to cover temporary workers will advance Congress's original goals for UI. Part I discusses the demographic characteristics of temporary workers and their rapid growth in the workforce, paying special attention to workers hired by temporary help agencies. Part II explains UI's eligibility rules—its mechanisms to combat the claimant-side moral hazard problem—and explains how these rules disproportionately exclude temporary workers. Part III explains how UI currently stabilizes employment by imposing experience-rating on employers. In Part IV, this Note presents proposals for retrofitting UI's eligibility and experience-rating rules to enable UI to cover temporary workers adequately without exacerbating its moral hazard problems.

### I. TEMPORARY WORKERS

By the narrowest estimate, in February of 1997 temporary workers constituted 1.9% of the American workforce, or 2.3 million people.<sup>10</sup> Compared to permanent workers, temporary workers are more likely to be young, female, and nonwhite, to work part-time, and to hold multiple jobs.<sup>11</sup> Temporary workers can obtain jobs through a variety of work arrangements. Workers may be hired directly by a firm for a fixed time period or acquire discrete job assignments with various firms through a temporary help agency. Temporary workers may also work "on call"—they may be called to work by a particular employer only as needed. In February 1997, temporary help agencies employed 1% of the nation's workforce (1.3 million people), while 1.6% (2 million people) worked as on-call workers.<sup>12</sup> Of all these temporary work arrangements, most of the

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10. See Steven Hipple, *Contingent Work: Results from the Second Survey*, MONTHLY LAB. REV., Nov. 1998, at 22-24 & tbl.2 (reporting results of the February 1997 Supplement to the Current Population Survey).

11. See *id.* at 23-24 tbl.2, 26-27 tbl.5.

12. See Sharon R. Cohany, *Workers in Alternative Employment Arrangements: A Second Look*, MONTHLY LAB. REV. 3, 3 (Nov. 1998) (reporting results of the February 1997 Supplement to the Current Population Survey). By comparison, 6.7% of employed persons (8.5 million people) worked as independent contractors. See *id.* Independent contractors constitute an appropriate comparison pool, because, although they too are not permanent employees by definition, they accept temporary jobs for entirely different reasons. See *infra* Section II.B, tbl.2. Moreover, because UI does not cover independent contractors, employers often misclassify

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available data relate to temporary help workers (those workers referred by temporary help agencies). This Note thus focuses in particular on the plight of temporary help workers.

In general, employment through temporary help agencies is extremely sensitive to the business cycle. While annual aggregate employment growth over the last quarter-century has ranged from -2% during recessions to +5% during recoveries, temporary services employment growth has fluctuated between -8% and +30% during such periods.<sup>13</sup> The National Association of Temporary and Staffing Services (“NATSS”), the temporary help industry’s trade association, estimated that while the industry employed one million workers at any given time during 1988, about *six million* people worked as temporary help workers over the course of the year.<sup>14</sup> The fact that the hiring of temporary help workers fluctuates with the business cycle supports the claim that employers rely on temporary help workers to replace personnel during short-term absences, to fulfill increased labor requirements during demand surges, and to acquire specialized expertise for short-term discrete projects.

Yet the temporary help industry also has experienced dramatic *long-term* growth—from 165,000 workers in 1972 to over two million by 1995—at an annual growth rate of 11.8%.<sup>15</sup> From 1989 to 1994, the number of workers employed by temporary help agencies rose by almost 350,000, or 43%; non-farm employment grew by approximately 5% during the same period.<sup>16</sup> What caused this rapid growth of temporary help workers? Some studies argue that employers increased their use of temporary help workers in order to reduce labor costs in the face of heightened competition and increased product demand.<sup>17</sup> In the same vein,

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their temporary workers as independent contractors to avoid FUTA taxes. *See infra* notes 125-128 and accompanying text.

13. *See* Lewis M. Segal & Daniel G. Sullivan, *The Growth of Temporary Services Work*, J. ECON. PERSP., Spring 1997, at 117, 118 (reporting calculations based on data from the National Association of Temporary and Staffing Services).

14. *See* Françoise J. Carré et al., *Piecing Together the Fragmented Workplace: Unions and Public Policy on Flexible Employment*, in UNIONS AND PUBLIC POLICY: THE NEW ECONOMY, LAW, AND DEMOCRATIC POLITICS 13, 17 n.6 (Lawrence G. Flood ed., 1995).

15. *See* Segal & Sullivan, *supra* note 13, at 118.

16. *See* Bureau of Labor Statistics, Dep’t of Labor, New Survey Reports on Wages and Benefits for Temporary Help Services Workers, <<http://stats.bls.gov/news.release/occomp.toc.htm>> (visited April 26, 1998) (reporting results of the November 1994 Supplement to the Current Population Survey).

17. *See, e.g.*, Lonnie Golden & Eileen Appelbaum, *What Was Driving the 1982-88 Boom in Temporary Employment?: Preferences of Workers or Decisions and Power of Employers*, 51 AM. J. ECON. & SOC. 473 (1992) (attributing the boom to intensified competition in product markets, volatility in product demand, and the decline in relative bargaining power of unions); Karylee Laird & Nicolas Williams, *Employment Growth in the Temporary Help Supply Industry*, 17 J. LAB. RES. 663 (1996) (attributing growth in temporary help supply industry in part to firms’ efforts to reduce costs while maintaining flexible work force in face of increases in aggre-

temporary help industry sources argue that employers shifted to temporary work in part as a human resources tool, evaluating job performance of potential employees during a probationary period of temporary work and recruiting for permanent employment based on this evaluation. A 1994 NATSS survey found that 38% of temporary services workers reported having been offered permanent jobs at the firms at which they had worked as temps.<sup>18</sup> An Olsten Corporation survey found that two-thirds of employers surveyed reported using outside temporary help firms as a way of finding qualified permanent employees.<sup>19</sup>

Other explanations locate the causes of the temporary work boom in changing workforce demographics. According to one argument, the increase in the number of women and young people in the workforce caused the growth in temporary work, because these new entrants *prefer* shorter work weeks and greater flexibility in work hours.<sup>20</sup> Finally, a potential source of long-term growth may stem from welfare reform. In 1996, Congress changed federal welfare policy by allocating block grants to states for the support of their public assistance programs,<sup>21</sup> but attached the condition that states set duration limits for need-based assistance<sup>22</sup> and require welfare recipients to look for work.<sup>23</sup> Although there is little data on the kinds of jobs that these "workfare" recipients actually accept after states terminate their benefits, their low average skill level may force them to turn to temporary work.<sup>24</sup>

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gate output and heightened foreign competition). Some writers assert that, as courts began to carve out exceptions to the "employment-at-will" doctrine, *see infra* note 26, the market responded by increasing the demand for temporary workers. *See, e.g.,* Dwight R. Lee, *Why Is Flexible Employment Increasing?*, 17 J. LAB. RES. 543 (1996). At this time, however, no significant body of evidence supports this claim.

18. *See* Segal & Sullivan, *supra* note 13, at 124.

19. *See* Robert L. Rose, *A Foot in the Door*, WALL ST. J., Feb. 27, 1995, at R7.

20. *See, e.g.,* Laird & Williams, *supra* note 17, at 677 (attributing growth in temporary help supply industry in part to the continued growth in the number of married females in the labor force). *But see* Golden & Appelbaum, *supra* note 17, at 485-87 (finding no effect of increases in married women, younger workers, and older workers in the labor force).

21. *See* Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, § 103(a), 110 Stat. 2105, 2116.

22. *See id.* at 2133.

23. *See id.* at 2129.

24. *Cf.* Brendan Lynch, Note, *Welfare Reform, Unemployment Compensation, and the Social Wage: Dismantling Family Support Under Wisconsin's W-2 Workfare Plan*, 33 HARV. C.R.-C.L. L. REV. 593, 602-09 (1998) (arguing that participants in Wisconsin's workfare program will tend not to find permanent work). Although former welfare recipients who enter the workforce can be expected to have joblessness rates that are twice the national average, only one in five will be able to meet UI eligibility criteria. *See* Wayne Vroman, *Effects of Welfare Reform on Unemployment Insurance*, THE NEW FEDERALISM: ISSUES AND OPTIONS FOR STATES 2 (The Urban Institute, 1998); *see also* CYNTHIA K. GUSTAFSON & PHILLIP B. LEVINE, LESS-SKILLED WORKERS, WELFARE REFORM, AND THE UNEMPLOYMENT INSURANCE SYSTEM (National Bureau of Econ. Research Working Paper No. 6489, 1998).



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Because of the claimant-side moral hazard problem, it matters why people accept temporary work. Some workers accept temporary employment even though they would prefer permanent work, because they have either immediate consumption needs or few job prospects. On the other hand, some workers may accept temporary work because they prefer the time flexibility it affords them or because they do not need a permanent job to meet their income needs.<sup>25</sup> UI benefits should be available to workers acting on the first set of reasons, because these persons cannot proactively reduce the risks attached to their behavior—in this case, accepting a job with a higher risk of unemployment. Workers acting on the second reason, however, create a moral hazard problem, because they shift the cost of the higher risk of unemployment onto UI even when it is well within their means to act to lower that risk.

To be sure, the risk of unemployment from permanent work is not necessarily lower in any particular instance. Permanent work is *on average* more stable than temporary work, however, because temporary workers are *guaranteed* to be unemployed when they complete their fixed term of work or their job assignment. Moreover, permanent workers have been granted certain protections that have little meaning for temporary workers.<sup>26</sup> In 1997, less than two percent of workers hired by

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25. In theory, workers may also prefer permanent work but accept temporary work if they have extracted a wage premium as compensation for the higher risk of unemployment associated with temporary work. Since permanent workers earn more on average than temporary workers, *see infra* Section II.A, most temporary workers do not fall into this category. Moreover, in theory, the UI benefit level—multiplied by the probability that the applicant will qualify for benefits—indirectly sets the floor for that wage premium, because a worker will not work for an amount that he or she could receive from UI by becoming unemployed. Therefore, the wage premium is lower than it would be if temporary workers could qualify for UI benefits.

26. The default position of American employment law is “employment-at-will”: Absent statutorily banned forms of discrimination or an express agreement to the contrary, an employer can fire an employee for good reason, bad reason, or no reason at all. *See* J.N. DERTOUZOS & L.A. KAROLY, LABOR MARKET RESPONSES TO EMPLOYER LIABILITY 5-6 (1992). In the 1980s, courts carved several exceptions into this the employment-at-will baseline. *See id.*; Alan B. Krueger, *The Evolution of Unjust-Dismissal Legislation in the United States*, 44 INDUS. & LAB. REL. REV. 644, 658 (1991). The implied contract exception allows various factors—including length of the employee’s service, personnel policy, industry practice, and assurances of continued employment—implicitly to rebut the presumption that the employment contract is terminable at-will. *See* DERTOUZOS & KAROLY, *supra*, at 6. The public policy exception prohibits the discharge of employees for reporting criminal activity, for disclosing illegal, unethical, or unsafe practices, or for exercising a statutory right or privilege, such as jury service. *See id.* at 6. Finally, under the covenant of good faith and fair dealing, discharge must always be “for cause” for the employer to have executed the employment contract in good faith. *See id.* at 7. These exceptions, however, do not protect temporary workers, because they do not become unemployed because of employer discharge without good reason. Indeed, the fixed duration of a temporary worker’s job is an express provision of the employment contract and does not violate current public policy.

temporary help agencies were represented by a union or an employee association.<sup>27</sup> And a prior history of temporary jobs has a long-term negative effect on lifetime wages, even fifteen years after the temporary work has ended.<sup>28</sup> By retrofitting UI to cover temporary workers who prefer permanent work, UI not only can provide them with significant monetary relief but also enable them to use their UI benefits to finance their search for work in the more stable world of permanent employment.

## II. HOW DOES UI CURRENTLY EXCLUDE TEMPORARY WORKERS?

While Congress created unemployment insurance to assist temporarily unemployed workers, UI planners designed eligibility rules to curb the claimant-side moral hazard problem. These moral hazard mechanisms embody the principle that unemployment insurance should target only those persons who are temporarily unemployed *through no fault of their own*. The rationales for this principle are both fiscal and moral. Covering all unemployed persons, even those who actively choose to be unemployed, would bankrupt UI. More importantly, unemployed persons who did not cause their unemployment deserve the state's help more than those who actively put themselves in that position.

An applicant for UI must leap over several eligibility hurdles to receive benefits. First, most states require a claimant to have earned a

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Most federal employment statutes also offer inadequate protection for temporary workers. See Anthony P. Carnevale et al., *Contingent Workers and Employment Law*, in CONTINGENT WORK: AMERICAN EMPLOYMENT RELATIONS IN TRANSITION 281-301 (Kathleen Barker & Kathleen Christensen eds., 1998) [hereinafter CONTINGENT WORK]; Daniel C. Feldman & Brian S. Klaas, *Temporary Workers: Employee Rights and Employer Responsibilities*, 9 EMPLOYEE RESPS. & RTS. J. 1, 6-16 (1996). For example, the Fair Medical Leave Act also will not cover most temporary workers, because it defines "eligible employee" as an employee who has been employed for at least 12 months by the employer for at least 1250 hours of service at a work site with at least 50 employees within a seventy-five mile radius. 29 U.S.C. § 2611(2)(A)-(B) (1994); 29 C.F.R. § 825.110(a) (1998); see Carnevale et al., *supra*, at 293. Under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e to 2000e-17 (1994), the Americans with Disabilities Act, 42 U.S.C. §§ 12101-12213 (1994), and the Age Discrimination in Employment Act, 29 U.S.C. § 201-209 (1994), however, if a worker does qualify as an "employee" of a temporary agency, but the agency's client to whom the worker is assigned discriminates against the worker, the client firm, though nominally not the "employer," may still be liable for interfering with an individual's employment opportunities with another employer. See Equal Employment Opportunity Commission, *Enforcement Guidance: Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms*, in EEOC COMP. MAN. (BNA) No. 231, at 3318-19 (Dec. 3, 1997).

27. See Cohany, *supra* note 12, at 17. This low unionization rate stems both from difficulties in organizing temporary workers and from obstacles provided by labor law itself. See Virginia L. duRivage et al., *Making Labor Law Work for Part-Time and Contingent Workers*, in CONTINGENT WORK, *supra* note 26, at 266-69.

28. Marianne A. Ferber & Jane Waldfogel, *The Long-Term Consequences of Nontraditional Employment*, MONTHLY LAB. REV., May 1998, at 3, 10-11, tbls.6-7 (indicating that between 1979 and 1993, past temporary work had negative effect on present wages).

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minimum amount from work during a year-long period prior to his or her UI application. Second, an applicant must have left his or her job *involuntarily*: States can deny benefits for (1) voluntary separation from employment without “good cause,” (2) discharge due to job-related misconduct, (3) unemployment because of a labor dispute, and (4) fraud to obtain or increase benefits. Once an applicant begins receiving benefits, the recipient faces additional requirements for maintaining eligibility. First, the recipient must be able and available to work. Second, the recipient must be actively looking for work and must submit evidence of that job search activity to UI agency officials. Third, the recipient cannot refuse an offer of suitable work without good cause. Violation of any of these continuation requirements will result in the postponement of benefits or disqualification from the program.<sup>29</sup>

Several studies indicate that UI eligibility rules significantly affect the coverage of the unemployment insurance system. In particular, many studies have concluded that more restrictive UI eligibility rules promulgated by the states in the early 1980s have contributed significantly to the long-term decline in the proportion of the unemployed who have received UI benefits in the past two decades.<sup>30</sup> Indeed, more restrictive UI eligibility rules also affect the application rate. If persons who have lost their jobs do not believe they qualify for benefits, they often will not ap-

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29. See Amy B. Chasanov, *Clarifying Conditions for Nonmonetary Eligibility in the Unemployment Insurance System*, 29 U. MICH. J. L. REF. 89, 90-94 (1996).

30. See MARC BALDWIN & RICHARD MCHUGH, UNPREPARED FOR RECESSION: THE EROSION OF STATE UNEMPLOYMENT INSURANCE COVERAGE FOSTERED BY PUBLIC POLICY IN THE 1980s (Economic Policy Inst. Briefing Paper, Feb. 1992); WALTER CORSON & WALTER NICHOLSON, U.S. DEP'T OF LABOR, AN EXAMINATION OF DECLINING UI CLAIMS DURING THE 1980s (Unemployment Ins. Occasional Paper 88-3, 1988); Marc Baldwin, *Benefit Reciprocity Rates Under the Federal/State Unemployment Insurance Program: Explaining and Reversing Decline* (1993) (unpublished Ph.D. dissertation, Massachusetts Institute of Technology) (on file with author). *But cf.* Rebecca M. Blank & David Card, *Recent Trends in Insured and Uninsured Unemployment: Is There an Explanation?* 106 Q. J. ECON. 1157, 1188 (1991) (finding that a slight increase in the proportion of eligible unemployed offset the negative effect of more restrictive eligibility rules).

Other factors that have affected or currently affect UI reciprocity include the decline of the manufacturing sector, the level of benefits provided, the federal taxation of UI benefits, and the decline of the unionized workforce. See BALDWIN & MCHUGH, *supra*, at 18 (manufacturing); CORSON & NICHOLSON, *supra*, at 119-20 (manufacturing); Patricia M. Anderson & Bruce D. Meyer, *Unemployment Insurance Takeup Rates and the After-Tax Value of Benefits*, 112 Q. J. ECON. 913 (1997) (taxation of benefits); John W. Budd & Brian P. McCall, *The Effect Of Unions on the Receipt of Unemployment Insurance Benefits*, 50 INDUS. & LAB. REL. REV. 478 (1997) (decline of unionized workforce); Brian P. McCall, *The Impact of Unemployment Insurance Benefit Levels on Reciprocity*, 13 J. BUS. & ECON. STAT. 189 (1995) (benefit levels). For a summary of relevant literature, see Daniel P. McMurrer & Amy Chasanov, *Trends in Unemployment Insurance Benefits*, MONTHLY LAB. REV., Sept. 1995, at 30.

ply.<sup>31</sup> Thus, the terms of UI's eligibility rules are worth examining carefully.

### A. *Minimum Earnings*

Most states require that a claimant of UI benefits has earned a certain minimum amount during a "base period." Most states use the traditional base-period definition—the first four of the past five completed calendar quarters. The minimum earnings amount for the base period varies considerably by state, ranging from a low of \$130 in Hawaii to a high of \$3400 in Florida.<sup>32</sup> Many states also require that the highest quarterly earnings in the base period meet a separate minimum earnings amount. In addition, many states require applicants to have earnings in at least two of the four base-period quarters. For example, applicants in California either must have earned at least \$1300 in the highest quarter of the base period *or* must have earned at least \$900 in the highest quarter and obtained total base-period earnings of at least 1.25 times the highest quarterly earnings.<sup>33</sup>

Policy analysts say that UI's monetary eligibility requirements screen applicants based on their degree of labor market attachment. This really means that UI allocates individual responsibility for unemployment by construing low past earnings as a proxy for a present unwillingness to work. In doing so, UI assumes that past earnings are a better proxy for present willingness to work than other measures (such as past number of hours worked and expressed preference for work over unemployment). In practice, a state can increase or decrease its minimum earnings threshold to adjust for inflation, and, more importantly, to expand or reduce its potential beneficiary pool. For example, out of 1.9 million UI claims filed in California in 1996, 26% of them were rejected because the applicants had insufficient base-period earnings.<sup>34</sup>

Temporary workers are especially at risk for having insufficient base-period earnings for three reasons. First, temporary workers earn less than permanent workers on an annual basis, because they work fewer hours per week and for fewer weeks than permanent workers. In February

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31. See WAYNE VROMAN, U.S. DEP'T OF LABOR, THE DECLINE IN UNEMPLOYMENT INSURANCE CLAIMS ACTIVITY IN THE 1980S 26 tbl.4 (Unemployment Ins. Occasional Paper 91-2, 1991) [hereinafter VROMAN, DECLINE] (finding that, based on the May 1989 supplement to the Current Population Survey, 52.8% of persons who had lost their jobs and did not apply for UI benefits did not do so because they believed they were not eligible).

32. EMPLOYMENT & TRAINING ADMIN., UNITED STATES DEP'T OF LABOR, COMPARISON OF STATE UNEMPLOYMENT INSURANCE LAWS 3-35 to 3-37 tbl.304 (1996 & Supp. 1997, 1998) [hereinafter STATE UI COMP.].

33. See *id.* at 3-27 tbl.301, 3-27 n.13.

34. CALIFORNIA BUDGET PROJECT, MAKING THE UNEMPLOYMENT INSURANCE SYSTEM WORK FOR CALIFORNIA'S LOW WAGE WORKERS 8-9 (1997).

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1997, temporary workers worked 28.6 hours per week on average.<sup>35</sup> In the temporary help industry, estimates of median duration of a job assignment range from fewer than ten weeks<sup>36</sup> to five months.<sup>37</sup> Second, temporary workers earn lower wages on average. In February 1997, even under a broad definition of temporary workers that included independent contractors, full-time temporary workers earned a median weekly wage of \$417, or 80% of what permanent workers earned.<sup>38</sup> Table 1 shows that the median weekly earnings of different kinds of full-time temporary workers are, on the whole, significantly lower than those of full-time permanent workers.<sup>39</sup>

**Table 1 Median weekly earnings of full-time workers by work arrangement, February 1997 (in dollars)**

	On-Call Workers	Temporary Help Agency	Permanent Work
<b>Total</b>	432	329	510
Men	508	385	578
Women	286	305	450
White	455	324	524
Black	378	332	428
Hispanic	321	281	357

These earnings disparities may reflect differences in the occupations of workers in the different work arrangement categories. In 1997, workers employed by temporary help agencies worked predominantly in the manufacturing and service industries. Over half of female temporary workers held clerical jobs, while forty-one percent of male temporary workers worked as operators, fabricators, or laborers.<sup>40</sup>

Finally, temporary workers may be disproportionately harmed by the fact that the traditional base-period definition excludes amounts earned during the current quarter and during the most recently completed quarter. In most states, UI agencies obtain wage information by requiring employers to send in their wage records every quarter. The required reporting date is usually the last day of the month *following* the end of the quarter to give employers additional time to

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35. See Hipple, *supra* note 10, at 27 tbl.5.

36. See Edward A. Lenz, *Flexible Employment: Positive Work Strategies for the 21st Century*, 17 J. LAB. RES. 555, 562 (1996).

37. See Cohany, *supra* note 12, at 16.

38. See Hipple, *supra* note 10, at 28.

39. This table presents data reported in Cohany, *supra* note 12, at 16 tbl.12.

40. See Cohany, *supra* note 12, at 14.

gather and send their quarterly wage information. When the UI agency receives the wage records, however, it takes more time to enter and process the wage information into the UI agency's computer system.<sup>41</sup>

To accommodate these delays, most states build in a lag period before the quarter in which the claimant applies. In states that follow the traditional base-period definition—the first four of the last five completed calendar quarters—the time lag lasts at least three months. To illustrate, assume that a worker loses her job and files a UI claim on January 15, 1999. Applying the traditional base-period definition, the UI agency would have to look at the past five completed calendar quarters, but would count only earnings from the first four quarters:

- 1st Quarter (Oct.-Dec. 1997) Earnings Counted
- 2nd Quarter (Jan.-Mar. 1998) Earnings Counted
- 3rd Quarter (Apr.-June 1998) Earnings Counted
- 4th Quarter (July-Sept. 1998) Earnings Counted
- 5th Quarter (Oct.-Dec. 1998) *Earnings Disregarded*
- Filing Month (Jan. 1-14, 1999) *Earnings Disregarded*

Even though the claimant had earnings during the fifth quarter and in the weeks prior to applying for UI benefits, UI agencies essentially ignore those earnings in order to give employers and themselves additional time to process claims. In fact, some states build in longer time lags. California's base-period definition builds in a time lag that lasts between four to seven months.<sup>42</sup>

By excluding a claimant's most recent earnings from her UI eligibility calculation, however, UI disproportionately disqualifies claimants who apply for UI immediately upon termination. Claimants who would have been eligible had UI counted their most recent earnings have to wait several months to qualify for UI. As a result, the time lag built into the traditional base-period definition disproportionately harms temporary workers. Because they suffer from lower average wages, hours, and job duration, it is reasonable to suppose that temporary workers are less likely to be able to rely upon savings and wait until the lag period passes. Thus, temporary workers may be more likely to apply for UI benefits immediately after they become unemployed, and not have their most recent earnings counted toward their monetary eligibility.

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41. See WAYNE VROMAN, U.S. DEP'T OF LABOR, THE ALTERNATIVE BASE PERIOD IN UNEMPLOYMENT INSURANCE: FINAL REPORT 25 (Unemployment Ins. Occasional Paper 95-3, 1995) [hereinafter VROMAN, ALTERNATIVE BASE PERIOD].

42. See STATE UI COMP., *supra* note 32, at 3-2.

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### B. “Involuntary” Unemployment

Even if an applicant meets the minimum earnings requirements, UI eligibility rules further limit the pool of recipients to persons unemployed *involuntarily*—that is, through no fault of their own. Thus, even those individuals who actively quit their job can qualify for UI benefits if their quitting was justified by a “good cause.” Good causes for quitting include sexual or other discriminatory harassment, illness or injury (with physician’s advice), pregnancy (with physician’s advice), acceptance of another job in good faith, or new employment circumstances.<sup>43</sup> Importantly, there is no *objective* line between involuntary and voluntary unemployment. All unemployment has a voluntary element, because a worker can always choose to accept work of any kind, no matter how odious or abhorrent. All unemployment also has an involuntary element, insofar as a worker cannot choose his or her range of options for work, but must choose from *among* the options available at any given time. Thus, each “good cause” exception to this “involuntary” unemployment requirement advances a particular policy goal.

Most jurisdictions, however, refuse to recognize a “good cause” exception for workers who leave their job after completing temporary work. In 1994, an individual who left his or her job after the completion of an assignment with a temporary agency would be always or usually eligible in only five states; eligibility would vary in twenty-six states; and the person would never be eligible in twenty states.<sup>44</sup> To be sure, some state courts have construed their “involuntary” requirement liberally in favor of temporary workers. For example, the Vermont Supreme Court has held that an employee who accepts temporary employment does not necessarily leave that work voluntarily at the end of the agreed-upon period, because where there is “no evidence suggesting that it was the employee who asked that the term of employment be limited, it may be presumed that the employer dictated the terms of the agreement.”<sup>45</sup> The court will deem the temporary worker to have departed involuntarily, however, “if it is shown that the employee requested temporary employment in light of his or her needs or availability.”<sup>46</sup> Other courts have refused to hold that temporary workers left voluntarily after they had completed their fixed term of employment where the particular facts of the case indicated that the employer offered temporary work on a take-it or leave-

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43. See Chasanov, *supra* note 29, at 106 tbl.4 (based on 1994 survey of UI agency practices in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands).

44. See *id.*

45. *Lincoln v. Department of Employment and Training*, 592 A.2d 885, 887 (Vt. 1991).

46. *Id.* at 888.

it basis or that the worker would have continued to perform the work had the job continued.<sup>47</sup>

Meanwhile, in February 1997, more than half of temporary help agency workers and on-call workers said that they would prefer a full-time permanent job over temporary work.<sup>48</sup>

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47. See *State Dep't of Indus. Relations v. Montgomery Baptist Hosp., Inc.*, 359 So. 2d 410, 413 (Ala. Civ. App. 1978) (holding that the claimant's departure after the end of fixed-term pharmacy internship amounted to involuntary termination on grounds that job "ceased to exist" where claimant requested extension of job duration but employer denied request due to lack of funding); *Cervantes v. Administrator*, 411 A.2d 921, 923 (Conn. 1979) (holding that a symphony violinist did not voluntarily quit after the end of a fixed-term contract, because "due to the nature of [her] work, she was bound either to accept or reject the contract term offered by the employer"); *City of Lakin v. Kansas Employment Sec. Bd. of Review*, 865 P.2d 223, 225 (Kan. Ct. App. 1993) (holding that employee who left his fixed-term job did not voluntarily leave, because he had "no realistic choice in determining the duration of work," but was offered the job "on a take-it or leave-it basis"); *Kentucky Unemployment Ins. Comm'n v. American Nat'l Bank & Trust Co.*, 367 S.W.2d 260 (Ky. Ct. App. 1963) (holding that an employee who accepted temporary work did not voluntarily quit when that work came to an end, "because had the need for the work continued he would have continued to perform"); *Walker Mfg. Co. v. Pogreba*, 316 N.W.2d 315, 317 (Neb. 1982) (finding claimant did not voluntarily quit after expiration of fixed term, even where permanent work was available with the employer at time of departure, because claimant was not asked to stay on and not informed about availability of permanent work); see also *Intermountain Jewish News, Inc. v. Industrial Comm'n*, 564 P.2d 132, 133 (Colo. Ct. App. 1977) (holding that the claimant's knowledge of and agreement to a fixed term could not deprive the claimant of UI benefits); *Campbell Soup Co. v. Board of Review*, 100 A.2d 287, 290 (N.J. 1953) ("Applicants for work very frequently must take jobs which the employers tell them at the time will engage their services for only a stipulated period. It would not be suggested that voluntary acceptance of such work, knowing in advance its fixed duration, constitutes the leaving of it at the agreed time a voluntary leaving . . ."). Compare 68 DEL. LAWS 421 (1992) (stating that "[a]n individual who becomes unemployed solely as a result of completing a period of employment that was of a seasonal, durational, temporary or casual duration will not be considered as a matter of law to have left such work voluntarily without good cause attributable to such work on the basis of the duration of the employment") with *City of Wilmington v. Unemployment Ins. Appeal Bd.*, 516 A.2d 166, 169 (Del. 1986) (construing the statute to apply to work that is six months or longer). But see *Calkins v. Board of Review of Dep't of Employment Sec.*, 489 N.E.2d 920 (Ill. App. Ct. 1986) (holding that "an unrefuted statement that the claimant did not desire any more work than she anticipated performing for the plaintiff seems effectively to bar her claim for unemployment benefits").

48. The data in Table 2 are reported in Cohany, *supra* note 12, at 12 tbl.8, 13 tbl.9.



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**Table 2. Employed workers by preference and reason for accepting non-permanent work, Feb. 1997 [percent distribution]**

	<i>Independent Contractors</i>	<i>On-Call Workers</i>	<i>Temporary Help Workers</i>
<b>Total, 16 years and over (in thousands)</b>	8,456	1,996	1,300
Prefer traditional arrangement	9.3	50.1	59.2
Prefer indirect or alternative arrangement	83.6	40.0	33.5
It depends	4.6		4.8
Not Available	2.5	3.5	2.5
<b>Reason for Arrangement</b>			
Economic reason	9.4	40.7	59.6
Only type of work I could find	2.7	27.1	34.6
Hope job leads to permanent employment	0.7	5.3	17.7
Other economic reason	6.0	8.3	7.2
Personal reason	76.0	39.4	29.3
Flexibility of Schedule	23.6	22.4	16.1
Family or personal obligations	3.9	6.0	2.4
In school or training	0.6	6.4	4.5
Other personal reason	48.0	4.6	6.4
Reason not available	14.6	19.9	11.1

Strikingly, almost 60 percent of temporary help workers prefer permanent work, and almost the same percentage accept temporary work for economic reasons. About 35 percent accepted temporary work because it was the only work they could find, while 18 percent accepted temporary work in the hope that they could obtain a permanent job with the same employer. To be sure, temporary workers' preferences will vary by industry and skill level. For example, a survey of temporary workers in the medical industry found that when asked to reveal their most important reason for taking temporary work, 8.2% of the respondents indicated that they viewed temporary work to be a "stopgap measure until I can obtain a permanent job," while 60.2% indicated that temporary work gave them "freedom to schedule any work in a flexible manner."<sup>49</sup> Moreover, temporary workers' preferences may vary by region. One survey of temporary help workers in the Southeast found that 77% deemed

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49. Martin J. Gannon, *Preferences of Temporary Workers: Time, Variety, Flexibility*, MONTHLY LAB. REV., Aug. 1984, at 28. This finding did not vary considerably across various occupations within the medical industry, despite the different skill levels required by the different medical occupations. Indeed, this survey found an inverse correlation between skill level and the total number of days that respondents preferred to work each week: 70.9% of nurses' aides and 66.3% of homemakers wanted to work five days or more per week. In contrast, 44.2% of registered nurses and 56.1% of licensed practical nurses wanted to work five days or more per week. *See id.* at 27.

their work to be “involuntary.”<sup>50</sup> Despite these possible variations in preferences, the evidence suggests that a person who accepts temporary work does not necessarily prefer temporary work.

Nevertheless, several states will disqualify temporary help workers under their “involuntary” quit requirement if, upon completion of a job assignment, they fail to notify their temporary help agency that they are available for work.<sup>51</sup> This requirement benefits temporary agencies, because they can avoid UI tax liability for a temporary worker who is about to qualify for UI by offering her another job assignment.<sup>52</sup> In the early 1980s, temporary agencies often would offer a one-day assignment to a worker when the worker was about to qualify for UI, usually at the end of the first week of full-time unemployment.<sup>53</sup>

Where states do not expressly require temporary help workers to report, some courts have treated the failure to report as amounting to a voluntary termination of employment; other courts have held, based on traditional contract principles, that the agreement to work on one job assignment does not bind a worker to report for additional assignments.<sup>54</sup> For example, in *Smith v. Employers' Overload Co.*,<sup>55</sup> the plaintiffs had obtained several different unskilled jobs through a temporary agency, each lasting only one day. After some of these one-day temporary jobs, the plaintiffs did not reapply to the temporary agency for more assignments, but instead applied for UI benefits. The state UI agency disqualified both plaintiffs, construing the refusal to reapply for temporary work as a voluntary decision to quit. The Minnesota Supreme Court, however, held that the plaintiffs had not voluntarily abandoned continuing employment, but rather merely had failed to appear for a possible offer of

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50. Daniel C. Feldman et al., *Managing Temporary Workers: A Permanent HRM Challenge*, ORGANIZATIONAL DYNAMICS, Autumn 1994, at 50 tbl.1 (survey of 200 temporary workers from seven temporary help agencies in the Southeast).

51. See, e.g., ARK. CODE ANN. § 11-10-513(a)(2)(A) (Michie Supp. 1997); COLO. REV. STAT. § 8-73-105.3(2) & (3) (West Supp. 1998); DEL. CODE ANN. tit. 19 § 3327(b) (1995); FLA. STAT. ANN. ch. 443.101(10)(b) (Harrison 1995 & Supp. 1996); GA. CODE ANN. § 34-8-195(c) (1998); MICH. COMP. LAWS. § 421.29(1)(l)(i)(B) (1995); NEB. REV. STAT. § 48-628(1)(a) (1998); OKLA. STAT. tit. 40, § 2-404A(B) (West Supp. 1999); TEX. LAB. CODE ANN. § 207.045(h) (West 1996). Although this burden to report usually applies only when the temporary help agency has notified the worker of her obligation to do so, most temporary agencies print the reporting requirement on the time slip provided to the temporary worker. See NATIONAL EMPLOYMENT LAW PROJECT, MENDING THE UNEMPLOYMENT COMPENSATION SAFETY NET FOR CONTINGENT WORKERS 44 n.176 (1997) [hereinafter NELP].

52. See NELP, *supra* note 51, at 44-45.

53. See Françoise J. Carré, *Temporary Employment in the Eighties*, in NEW POLICIES FOR THE PART-TIME AND CONTINGENT WORKFORCE 78 & n.33 (Virginia L. duRivage ed., 1992).

54. See Deborah Maranville, *Changing Economy, Changing Lives: Unemployment Insurance and the Contingent Workforce*, 4 B.U. PUB. INT. L.J. 291, 310-11 (1995); NELP, *supra* note 51, at 45-47.

55. 314 N.W.2d 220 (Minn. 1981).

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employment. Since “the term of employment is determined by the intention of the parties,” the *per day* duration of their work meant that “[t]he intent of the parties was manifestly contrary to the notion of an ongoing employment relationship.”<sup>56</sup>

### C. Accepting Suitable Work

Once receiving benefits, temporary workers still face continuation requirements, which demand that the claimant be able to work, be available to work, actively seek work, and accept “suitable” offers of work. States may thus disqualify a temporary worker who receives UI for having refused a “suitable” offer of temporary work. The federal government sets the floor for “suitable” job offers by barring states from denying benefits to otherwise eligible persons who refuse to accept new offers “if the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality.”<sup>57</sup> Then, to determine “suitability,” most state UI agencies consider several factors: the degree of risk involved to health, safety, and morals; physical fitness; prior training; work experience; prior earnings; the length of unemployment; prospects for obtaining local work in the claimant’s customary occupation; and the distance of available work from the claimant’s residence.<sup>58</sup> No single factor is dispositive.

In practice, however, this suitability test makes it more difficult for temporary workers who have a prior history of temporary work to refuse job offers. In thirty jurisdictions, if a UI recipient who refuses the offer of temporary or commission work has no prior history of temporary work, that person will always or usually be found eligible for UI benefits. In twenty-two jurisdictions, that same person’s eligibility will be uncertain, and in only one jurisdiction will this worker rarely or never be found eligible. In contrast, only eight jurisdictions will always or usually find eligi-

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56. *Id.* at 223. Note that the court also adverted to MINN. STAT. § 268.09, subd. 1(1), which expressly bars treating separation from employment because of its temporary nature as a voluntary quit. *Id.* at 222. *But cf.* McDonnell v. Anytime Temporaries, 349 N.W.2d 339 (Minn. Ct. App. 1984) (holding that the plaintiff’s desire to look for full-time permanent work did not constitute “good cause” for refusing to complete a two-week assignment from temporary agency).

57. 26 U.S.C. § 3304(a)(5)(B) (1994).

58. *See, e.g.*, ALA. CODE § 25-4-78(5)(a) (1992 & Supp. 1998); ARK. CODE ANN. § 11-10-515(c) (Michie 1996 & Supp. 1997); FLA. STAT. ANN. § 433.101(2)(a) (Harrison 1995 & Supp. 1996); IND. CODE ANN. § 22-4-15-2(e) (Michie 1997); ME. REV. STAT. ANN. tit. 26, § 1193(3)(A) (West 1988); MD. CODE ANN., LAB. & EMPL. § 8-1005(b) (1991); MICH. COMP. LAWS ANN. § 421.29(6) (West 1995); MINN. STAT. ANN. § 268.095 subd. 9 (West Supp. 1999); MO. ANN. STAT. § 288.050(4) (West Supp. 1999); NEB. REV. STAT. § 48-628(3)(b) (1988); N.H. REV. STAT. ANN. § 282-A:32(d)(1) (1987 & Supp. 1998); N.M. STAT. ANN. § 51-1-7(C)(1) (Michie 1998); VT. STAT. ANN. tit. 21, § 1344(a)(2)(D) (1987); *see also* Chasanov, *supra* note 29, at 117 tbl.7.

ble a worker who has a recent history of temporary work. In twenty jurisdictions, the eligibility of such a worker will be uncertain; in twenty-five jurisdictions, the worker will be eligible rarely or never.<sup>59</sup>

For example, in *Henry v. Dolphin Temporary Help Services*,<sup>60</sup> the Minnesota Court of Appeals extended the reasoning of the *Smith*<sup>61</sup> decision and held that a claimant did not disqualify herself for UI benefits by refusing a temporary help agency's offer of re-employment in order to seek full-time permanent work.<sup>62</sup> In *Henry*, the claimant had declined temporary work after being laid off from a full-time position that she had held for sixteen years. In *Vejdani v. Western Temporary Services*,<sup>63</sup> however, the court held that an employee who had worked regularly for a temporary agency during her base period disqualified herself from UI benefits when she refused to accept an offer of comparable employment from the same temporary agency. UI recipients with a history of temporary work cannot refuse offers of temporary work without bearing the costs that permanent workers need not, even if the formerly temporary workers want to continue looking for permanent work.<sup>64</sup>

### III. EXPERIENCE-RATING

UI practices "experience-rating" to combat its *employer-side* moral hazard problem and to advance the goal of stabilizing employment. The federal government imposes unemployment payroll taxes on employers and employees on a taxable wage base no less than the first \$7000 of a worker's earnings.<sup>65</sup> States can, and currently do, have taxable wage bases above this effective federal minimum.<sup>66</sup> All states split a firm's UI tax into a uniform surcharge and an experience-rated tax component. The surcharge, applied to all employers uniformly, funds administration, deficits in the combined account, and benefits not charged to specific firm accounts. In the experience rated tax component, states charge employers

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59. See Chasanov, *supra* note 29, at 117 tbl.7 (based on a 1994 survey of UI agency practices in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands).

60. 386 N.W.2d 277 (Minn. Ct. App. 1986).

61. 314 N.W.2d 220 (Minn. 1981).

62. Cf. *Whitehead v. Moonlight Nursing Care, Inc.*, 529 N.W.2d 350 (Minn. Ct. App. 1995) (holding that temporary agency has burden of proving that it made a definite and express offer of suitable re-employment).

63. 486 N.W.2d 461 (Minn. Ct. App. 1992).

64. The exact percentage of temporary workers that face this situation, though unclear, is probably non-trivial. In February 1997, while about 37% of temporary help agency workers reported that they had been accepting temporary work for at least a year, 23% had been temporary workers for two or more years. See Cohany, *supra* note 12, at 16.

65. See 26 U.S.C. § 3306(b) (1994).

66. See STATE UI COMP., *supra* note 32, at 2-19, tbl.200. Over thirty-nine states have taxable wage bases above \$7,000. See *id.*

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additional tax for every former employee who qualifies for and receives UI benefits.<sup>67</sup>

Experience-rating is designed to discourage employers from adjusting their labor costs in ways that destabilize overall employment. All employers want to adjust their labor costs to meet changing demand and heightened competition. No employer wants to spend more on labor than necessary to meet the current consumer demand for its goods or services. Holding labor costs constant despite plummeting demand reduces profits. Furthermore, holding labor costs constant in the face of soaring demand limits production capacity, especially in labor-intensive industries. Employers who rely only on their existing internal labor pool to adjust labor costs face three kinds of problems. First, because internal labor markets are arranged in a clear hierarchy, adjustments to the wages paid for one job require adjustments to the wages for many related jobs. Second, in the long term, lowering the wages or hours of permanent workers may cause loss of morale, firm reputation, and loyalty. Third, other actors, such as unions or government regulatory agencies, may resist adjustments that would enhance organizational flexibility.<sup>68</sup>

If UI simply applied its payroll tax uniformly, without experience-rating, employers could shift those costs onto UI by temporarily laying off workers during slumps in consumer demand rather than keep those workers on the payroll. This temporary layoff strategy presents a moral hazard problem for UI systems, because employers control both the timing and duration of unemployment. With experience-rating, however, employers are essentially penalized for each former employee who receives UI benefits. Although employers can usually shift the uniform surcharge portion of their total UI tax burden to their workers through reduced wages and to consumers through higher prices, they cannot shift the experience-rated portion of their UI tax burden so easily.<sup>69</sup> As a result, experience-rating stabilizes employment because, at the margins, it discourages employers from using temporary layoffs as a method of adjusting labor costs. Several studies conclude that experience-rating stabilizes employment, especially in industries in which demand varies consid-

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67. Thirty-seven states charge base-period employers in proportion to their contribution to a claimant's base-period earnings. Eight states charge in inverse order of employment up to a specified amount. Ten states specify the employer to be charged (for example, the most recent employer). See *id.* at 2-33 tbl.205.

68. See Alison Davis-Blake & Brian Uzzi, *Determinants of Employment Externalization: A Study of Temporary Workers and Independent Contractors*, 38 ADMIN. SCI. Q. 195, 197 (1993).

69. See Patricia M. Anderson & Bruce D. Meyer, *The Effects of Firm Specific Taxes and Government Mandates with an Application to the U.S. Unemployment Insurance Program*, 65 J. PUB. ECON. 119 (1997).

erably throughout the year.<sup>70</sup> In addition, experience-rating also enhances horizontal equity, because in its absence firms and industries that face fairly stable consumer demand would effectively subsidize the labor cost adjustments of firms and industries with more variable consumer demand.<sup>71</sup>

However, there are several flaws in experience-rating practices. First, because UI systems set a maximum tax rate, employers are not penalized a full dollar in additional tax liability for every dollar of benefit received. Therefore, firms that have relatively high numbers of unemployed former employees—and are thus paying the maximum tax rate—will pay out, on average, less than their former employees receive in UI benefits. Because all employers pay a uniform tax rate, employers with low average unemployment subsidize employers with high average unemployment.<sup>72</sup> Second, there is a time lag between when UI disburses benefits to a claimant and when UI charges the claimant's former employer. Therefore, even if UI charged employers for the full nominal amount of the benefits their former employees received, the employers still would receive what amounts to an interest-free loan, since UI accounting systems do not charge interest on employers' deferred tax liabilities.<sup>73</sup> Third, because the traditional base period does not include earnings from employment in the lag quarter or for weeks in the filing month, employers for whom the claimant works only during these uncounted time periods do not get experience-rated.<sup>74</sup> Fourth, some states help employers by providing claimants with a "temporary layoff" exception to the "availability to work" eligibility requirement<sup>75</sup>—an exception allowing

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70. See e.g., Patricia M. Anderson, *Linear Adjustment Costs and Seasonal Labor Demand: Evidence from Retail Trade Firms*, 108 Q. J. ECON. 1015 (1993) (finding that UI experience-rating stabilizes employment in retail trade industry); BAICKER ET AL., *supra* note 1, at 31-33 (arguing that, at its inception, experience-rating modestly reduced employment fluctuations in highly seasonal industries).

71. See Patricia Anderson & Bruce D. Meyer, *Unemployment Insurance in the United States: Layoff Incentives and Cross Subsidies*, 11 J. LAB. ECON. S70 (1993).

72. See Robert Topel, *Financing Unemployment Insurance: History, Incentives, Reform*, in *UNEMPLOYMENT INSURANCE: THE SECOND HALF-CENTURY* 110-11 (W. Lee Hansen & James F. Byers eds., 1990).

73. See *id.* at 116.

74. See PAUL L. BURGESS & STUART A. LOW, U.S. DEP'T OF LABOR, *UNEMPLOYMENT INSURANCE AND EMPLOYER LAYOFFS* 53 (Unemployment Ins. Occasional Paper 93-1, 1993) (estimating that 27% of all otherwise chargeable layoffs were not charged because the claimant worked for employer(s) in the uncounted time periods).

75. In Delaware, Michigan, and Ohio, employees temporarily laid off for not more than 45 days are deemed available for work and actively seeking work if the employer notifies the agency that the layoff is temporary. Employees in Arkansas and Missouri are considered available for work and actively seeking work and therefore ineligible for UI benefits if they are temporarily laid off for no more than eight weeks. In New Mexico, an employee will be found to be available and actively seeking work if he or she is temporarily laid off for no more than four

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the very behavior that experience-rating seeks to prevent. Finally, because UI does not tax employers for employees who are ineligible for benefits, employers have a strong incentive to actively dispute their former employees' eligibility. It is difficult to determine what proportion of employers challenge UI eligibility purely to avoid additional tax liability, however, because there is no measure of eligibility apart from UI agency adjudications.

Without these flaws, experience-rating would discourage employers more effectively from temporarily laying off their workers during slumps in demand.<sup>76</sup> There is some evidence to suggest that incomplete experience-rating causes increased overall employment in seasonal industries and decreased employment in non-seasonal industries,<sup>77</sup> thereby increasing aggregate unemployment. By one estimate, incomplete experience-rating accounts for approximately 30% of temporary layoff unemployment.<sup>78</sup> From 1979 to 1984, more than 80% of workers with three or more benefit years were laid off by the same one or two of their employers. Not surprisingly, these repeat users of UI tended to concentrate in seasonal industries such as construction or manufacturing.<sup>79</sup>

In many ways, the hiring of temporary workers poses the same problem as the strategic use of temporary layoffs. Since temporary workers are employed only by job assignment or for a fixed term, employers have more flexibility in labor cost adjustment. As consumer demand rises, employers hire more temporary workers; as demand falls, employers hire fewer temporary workers.<sup>80</sup> The long-term increase in the use of temporary workers, however, has *destabilized* overall employment—precisely the problem UI was originally intended to address. Therefore, an adequate retrofit of UI must not only change eligibility rules to cover temporary workers, but also successfully experience-rate employers that use temporary workers. Such a retrofit would better stabilize overall employment, because it would encourage employers to prefer, on the mar-

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weeks or if the individual has an offer in writing for full-time work that will begin in four weeks. See STATE UI COMP., *supra* note 32, at 4-25 tbl.400, n.5.

76. See, e.g., David Card & Phillip B. Levine, *Unemployment Insurance Taxes and the Cyclical and Seasonal Properties of Unemployment*, 53 J. PUB. ECON. 1 (1994) (finding that during cyclical and seasonal slumps, imperfect experience-rating positively correlates with increases in temporary layoffs).

77. See Donald R. Deere, *Unemployment Insurance and Employment*, 9 J. LAB. ECON. 307, 324 (1991) (finding—based on 1962-69 data from 31 states using reserve ratio experience-rating—that imperfect experience-rating accounted for increased hiring in construction—1.7% increase in its share of employment—and decreased hiring in the services sector—almost a 1% decrease in employment share).

78. See Topel, *supra* note 72, at 123.

79. See BRUCE D. MEYER & DAN ROSENBAUM, REPEAT USE OF UNEMPLOYMENT INSURANCE 11-14 (National Bureau of Econ. Research Working Paper No. 5423, 1996).

80. See *supra* text accompanying note 13.

gins, a permanent workforce over a temporary workforce. Moreover, experience-rating will enhance horizontal equity by reducing cross-subsidization from firms that use temporary workers less frequently to firms that use temporary workers more often. Employers simply would be required to compare the labor costs savings of hiring the temporary worker with the cost in additional UI tax liability, multiplied by the likelihood that the worker will qualify for benefits.

To be sure, because more employers use temporary workers to obtain more flexibility in adjusting their labor costs, one might argue that placing on employers the additional disincentive of experience-rating hampers efficiency and creates a net loss in the economy. Hiring temporary workers has advantages. First, it reduces the firm's wage costs because temporary workers usually work for fewer hours and at lower wages. Second, because temporary workers expect short-term employment, the employer loses no loyalty. Third, the employer can hire skilled temporary workers to access highly specialized skills that the employer only needs for a short time or for a single project.

At the same time, however, there are serious disadvantages to hiring temporary workers. First, because temporary workers may be less motivated than permanent workers, the benefit of lower wages might be offset or overshadowed by low productivity.<sup>81</sup> Second, the firm's increased use of temporary workers may lower *permanent* workers' trust in the firm, because it signals that their own jobs are not as secure as they might have seemed.<sup>82</sup> Third, because temporary workers do not have firm-

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81. See Rajiv D. Banker et al., *A Field Study of the Impact of a Performance-Based Incentive Plan*, 21 J. ACCT. & ECON. 1996, at 195, 206-207, 222 (finding that sales gains after implementing a performance-based incentive plan in retail outlets were significantly lower when more temporary workers were used). Temporary workers' motivation may increase, however, as skill-level, personal autonomy, and workplace tenure increase. Cf. Jone L. Pearce, *Toward an Organizational Behavior of Contract Laborers: Their Psychological Involvement and Effects on Employee Co-Workers*, 36 ACAD. MGMT. J. 1082, 1090 (1993) (finding no significant difference between the organizational commitment of engineers and engineering technicians who were employees and those who were contract workers). Management strategies for solving this motivation problem include screening for individual motivation during hiring, fostering pride in work, holding out the reward of permanent work, and creating a pool of temporary employees who work intermittently but remain with the firm on a long-term basis. See John J. Lawrence, *Involving Temporary Workers in Process Improvement Activities*, QUALITY PROGRESS, Feb. 1997, at 74; see also Stanley D. Nollen & Helen Axel, *Benefits and Costs to Employers, in* CONTINGENT WORK, *supra* note 26, at 138-43.

82. Cf. Pearce, *supra* note 81, at 1090 (finding that employees who work with contract workers reported lower trust in their organization than employees in employee-only work units). Permanent workers not only should fear for their jobs but should fear that temporary workers will hamper their prospects for promotion. See William P. Barnett & Anne S. Miner, *Standing on the Shoulders of Others: Career Interdependence in Job Mobility*, 37 ADMIN. SCI. Q. 262 (1992) (examining clerical workforce in a Fortune 500 firm from 1973 to 1987 and finding



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specific skills, employers must monitor them more closely,<sup>83</sup> or must limit them to tasks that do not require firm-specific skills. By successfully experience-rating employers that hire temporary workers, UI simply would force those employers to bear the social costs of this labor cost adjustment strategy as well.

### IV. HOW TO RETROFIT UI TO COVER TEMPORARY WORKERS

Retrofitting UI's existing moral hazard mechanisms requires a tight-rope walker's balance. On the one hand, UI systems must experience-rate employers that use temporary workers, allow temporary workers to qualify at a lower earnings minimum, treat temporary workers who complete their jobs as if they had left those jobs involuntarily, and allow temporary workers to refuse subsequent offers of temporary work. On the other hand, these changes must not exacerbate the claimant-side moral hazard by allowing temporary workers to receive UI benefits when they could otherwise find suitable permanent work. Evaluations of the following proposals for retrofitting UI to cover temporary workers should bear these competing concerns in mind.

#### A. *Implement an Alternative Base Period*

To remedy the exclusionary effect of the traditional base-period definition, states should include the most recent earnings in determining eligibility. There would be no moral hazard tradeoff, because counting a claimant's most recent earnings would allow one to capture better that person's *current* willingness to work. In nine states, UI officials calculate eligibility based on an *alternative* base period when applicants do not meet traditional base-period requirements.<sup>84</sup> Unlike a traditional base pe-

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that the hiring of temporary workers slowed promotion among permanent workers at lower ranks, but accelerated promotion for permanent workers at higher ranks).

83. Cf. KEVIN D. HENSON, JUST A TEMP 85-112 (1996) (finding that intensive formal control removes temporary workers' personal motivation, loyalty, and commitment).

84. See ME. REV. STAT. ANN. tit. 26 § 1043(3-A) (West Supp. 1998) (defining the alternative base period as the last four completed calendar quarters); MASS. GEN. LAWS ANN. ch. 151A, § 1(a) (West 1996 & Supp. 1998) (the last three completed quarters); N.J. STAT. ANN. § 43:21-19(c)(1)(West Supp. 1998) (the last four completed quarters, or the last three calendar quarters in addition to the weeks worked in the filing quarter); N.Y. LAB. LAW § 520(2) (WESTLAW 1998) (the last four completed calendar quarters); N.C. GEN. STAT. § 96-8(18) (1997) (same, but reverts to the traditional base-period definition after September 1, 2001); OHIO REV. CODE ANN. § 4141.01(Q)(2) (Anderson 1998) (the last four completed calendar quarters); R.I. GEN. LAWS § 28-42-3(3)(1995) (same); VT. STAT. ANN. tit. 21, § 1301(17)(B) & (C)(1987) (the last four completed calendar quarters, or the last three calendar quarters in addition to the weeks worked in the filing quarter); WASH. REV. CODE ANN. § 50.04.020 (West 1990 & Supp. 1999) (the last four completed calendar quarters); see also N.H. REV. STAT. ANN. § 282-A:2(2) (1998) (same, but effective only for claims filed on or after April 1, 2001).

riod, an alternative base period counts the claimant's earnings in the lag quarter and the filing quarter. Using data from five states with alternative base-period provisions, one study found that the alternative base-period definition increased eligibility by six to eight percent.<sup>85</sup> Most importantly, an alternative base period would help temporary workers. In Washington state, of all the temporary or seasonal workers eligible for UI, 11.7% of them were eligible only under the state's alternative base-period definition.<sup>86</sup>

States that have an alternative base period implement it in two ways. In some states, when a claimant is ineligible under the traditional base-period definition, states do not wait until the next quarterly wage report arrives. Instead, they directly request wage records from employers for the lag quarter, usually giving employers ten days to reply. This "wage request" system increases accuracy in determining eligibility. The costs of such a system include the time for the UI agency to issue a request and for the employer to receive, fill out, and return the request. Moreover, employers may not respond to these requests, forcing UI to incur additional costs by contacting the employers by phone.<sup>87</sup> Thus, in Washington state in 1995-96, alternative base-period claims requiring wage requests took 20% longer to process, from filing to first payment, than traditional base-period claims.<sup>88</sup>

In contrast, Ohio uses a wage affidavit system, under which claimants must complete affidavits and present proof—such as paycheck stubs—of wages during the lag and current quarter.<sup>89</sup> Since the claimant provides the wage information directly to the UI agency, this method is the most expeditious means of obtaining wage information not currently in the state UI database. The main disadvantage of this method, however, is that the information in wage affidavits often may be inaccurate. Ohio's UI agency estimates that about 90% of the wage affidavits filed do not match the quarterly wage reports that employers subsequently submit.<sup>90</sup> Thus, the UI agency incurs additional administrative costs to correct for overpayments by amending benefit amounts and employer tax rates. Overpayments can be subtracted from subsequent payments to the claimant. Otherwise, the state or the employer must bear the loss.

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85. See VROMAN, ALTERNATIVE BASE PERIOD, *supra* note 41, at 6.

86. See PLANMATICS, INC., U.S. DEP'T OF LABOR, 5 IMPLEMENTING ABP: IMPACT ON STATE AGENCIES, EMPLOYERS, AND THE TRUST FUND 10 (Unemployment Ins. Occasional Paper 98-4, 1998).

87. See 2 *id.* at 8.

88. See *id.* at 11.

89. See *id.* at 8-9. New Jersey and Washington shift to a wage-affidavit system when the wage-request method fails.

90. See *id.* at 9.

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Despite their problems, both the wage request and the wage affidavit systems count more recent earnings than the current wage record system. Indeed, electronic transfer of wage information may alleviate problems in all three methods. Nevertheless, state UI administrators may actively resist technological upgrades because of the significant start-up and administrative costs. Consider the aftermath of *Pennington v. Doherty*.<sup>91</sup> In that case, the Seventh Circuit held that the traditional base-period definition violated § 303(a)(1) of the Social Security Act, the “when due” clause, which required states to have “such methods of administration as will reasonably insure the full payment of unemployment benefits to eligible claimants with the greatest promptness that is administratively feasible.”<sup>92</sup> The Seventh Circuit accepted the lower court’s finding that an alternative base period would significantly increase the number of eligible claimants (from 13,800 to 40,000), the amount of additional benefits paid out (\$30 million to \$40 million), and the speed of payment (from forty-five days to twelve weeks earlier), but would cost \$13.5 million for computer conversion and staff and \$2.6 million annually thereafter.<sup>93</sup> This legal victory for UI claimants, however, was short-lived. State UI agencies throughout the country took their case against *Pennington* to Congress,<sup>94</sup> after which Congress effectively overruled *Pennington* by passing a “clarifying provision” stating that any state law provision defining a base period cannot be considered a “method of administration” under § 303(a)(1).<sup>95</sup> The story of *Pennington* suggests that advocates of an alternative base period must overcome significant political obstacles.

### B. Lower Minimum Earnings Requirements

Although Congress never intended UI to solve the problem of low wages, legislatures can remedy the bias against low-wage workers built into UI’s minimum earnings requirements by relaxing them. To be sure, lowering the minimum earnings thresholds weaken the inference that applicants meeting those requirements are sufficiently willing to work.

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91. 110 F.3d 502 (7th Cir. 1996).

92. 20 C.F.R. § 640.4 (1998); *cf.* California Dep’t of Human Resources v. Java, 402 U.S. 121, 131 (1971) (interpreting the “when due” clause to require states to determine eligibility and pay benefits “at the time when payments are first administratively allowed as a result of a hearing of which both parties have notice and are permitted to present their retrospective positions.”).

93. *See Pennington*, 110 F.3d at 504-05.

94. *See Unemployment Insurance Issues: Hearings Before the Subcomm. on Human Resources of the House Comm. on Ways and Means*, 104th Cong. 9-42, 58, 113-115, 123-127, 131-141 (1997).

95. Balanced Budget Act of 1997, Pub. L. No. 105-33, § 5402, 111 Stat. 251, 603 (1997); *see Doherty v. Pennington*, 118 S. Ct. 292 (1997) (vacating and remanding “for further consideration in light of Pub. L. No. 105-33”).

The solution, however, is, first, to lower the minimum earnings thresholds and, second, to measure the willingness to work with minimum *hours worked* as well as wages earned. Although temporary workers work fewer hours on average than permanent workers, a minimum hours threshold does not disadvantage low-wage temporary workers as much as the minimum earnings requirements do. Currently, the State of Washington only requires that claimants have worked 680 hours in the base period. It sets neither a minimum earnings threshold nor minimum thresholds by quarter. Several states have eligibility rules that rely on a mix of hourly requirements and earnings requirements tied to the state's average weekly wage, minimum wage, or other relative measure.<sup>96</sup> Because they do not rely on earnings exclusively, base-period eligibility rules contain less of the low-wage bias that disproportionately harms temporary workers.

Relaxing the minimum earnings requirements, however, may substantially deplete state UI resources. For example, just reducing California's high-quarter earnings requirement from \$900 to \$300 would extend benefits to 258,000 more people—and would cost \$104 million.<sup>97</sup> The solution to this problem is to raise the federal taxable-wage base for UI. The federal government set the taxable wage base at \$7000 in 1983<sup>98</sup> and has not raised it since, despite wage growth over the last fifteen years. By keeping the taxable wage base at such a low level, UI effectively imposes higher taxes on employers of lower-wage workers. In other words, employers of low-wage workers effectively subsidize the benefits formerly higher-wage workers. Raising the federal taxable wage base will reduce this inequity. Although one might fear that taxing more of a worker's wages would reduce his or her incentive to work, one study concluded

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96. For example, Michigan requires that the claimant have been employed at least 20 weeks and have earned 30 times the state minimum hourly wage in that time. Alternatively, claimants in Michigan can qualify if they worked for 14 weeks and during the base period earned wages equal to 20 times the state's average weekly wage. In New Jersey, claimant must have worked for at least 20 weeks and earned either 20% of the statewide average weekly wage or 20 times the state's minimum wage. Alternatively, claimants in New Jersey can qualify if they have earned 12 times the average weekly wage during the base period *or* earned 1000 times the state's minimum hourly wage *or* worked 770 hours in the production and harvesting of agricultural crops. In New York, claimants must have worked 20 weeks during the base period and earned a minimum average weekly wage of either 21 times the minimum wage in effect on February 4, 1991, *or* \$80, whichever is greater. If the New York claimant cannot meet this requirement, she can still qualify if she has worked 15 weeks in the 52 week period and has worked a total of 40 weeks in the 104 week period preceding the base year. In Ohio, the claimant must have worked for 20 weeks during the base period and earned wages equal to 27.5% of the state's average weekly wage. See STATE UI COMP., *supra* note 32, at 3-27 to 3-28, tbl.301.

97. See CALIFORNIA BUDGET PROJECT, *supra* note 34, at 13-14.

98. See BLAUSTEIN, *supra* note 2, at 321.

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that doubling the federal taxable wage base to \$14,000 would have a negligible effect on employment levels.<sup>99</sup>

Nevertheless, a *fixed-dollar* tax base will always produce horizontal inequity between low-wage and high-wage workers as wage levels rise. Many states have thus adopted flexible tax bases constituted by a certain percentage of the state's average annual wage.<sup>100</sup> Those states that have not done so should adjust their taxable wage base accordingly. At a minimum, the federal government should raise the statutory floor of the taxable wage base by pegging it to a percentage of the federal minimum wage. In the alternative, states could peg any increase in the taxable wage base to the direct cost of expanding monetary eligibility. An initial increase in the taxable wage base will increase the reserves in the state's UI trust fund. If the costs of expanding monetary eligibility come out to less than the increase in the UI trust fund, the state could proportionately *reduce* the UI tax base over time. The higher administrative costs of implementing this kind of program may be worth paying to expand the taxable wage base in a political climate that remains inhospitable to tax increases of any kind.

### C. *Provide a "Good Cause" Exception for Persons Who Leave After Completing Their Temporary Work Assignments*

Congress should establish a bright-line "good cause" exception for temporary workers who leave after completing their fixed term, even if they requested temporary work, and even if they refused to report for additional temporary worker. Temporary workers should not be prevented from using UI benefits to alleviate the hardships of unemployment and to look for a new job.

There is no neutral way to distinguish between "voluntary" and "involuntary" acceptance of temporary work, even if the worker requests temporary work or refuses to report for temporary work. All contracts involve mutual coercion, because each of the parties has the legal power to withhold from the other party what it needs.<sup>101</sup> An employer can withhold wages from a worker, and a worker can withhold his labor from the employer. The contractual positions of both parties, therefore, depend on their power to coerce, their relative bargaining power. Courts invalidate contracts between parties with une-

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99. See ROBERT F. COOK ET AL., U.S. DEP'T OF LABOR, THE EFFECTS OF INCREASING THE FEDERAL TAXABLE WAGE BASE FOR UNEMPLOYMENT INSURANCE 60, 61 (Unemployment Ins. Occasional Paper No. 95-1, 1995).

100. See BLAUSTEIN, *supra* note 2, at 321; STATE UI COMP., *supra* note 32, at 2-19 tbl.200.

101. See Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603 (1943).

qual bargaining power not because they are somehow categorically coercive but because they are so coercive as to become *socially unacceptable*. The idea of coercion presumes a *normative* baseline against which a particular set of choices available to a person should be measured.<sup>102</sup>

Although some state courts have applied this insight in applying the “involuntary” quit requirement to temporary workers,<sup>103</sup> most jurisdictions still treat a temporary worker’s exit after her fixed term ends as amounting to a voluntary quit.<sup>104</sup> UI incorporates this insight more directly by allowing persons to quit for “good cause.” In many states, “good cause” for quitting includes sexual or other discriminatory harassment, illness, injury, or pregnancy. Each of these “good cause” exceptions stem from normative decisions that increase the bargaining power of workers in those situations by reducing the workers’ cost of exit. For example, without the “good cause” exception for discriminatory harassment, employers would have more coercive power over their employees. This kind of coercion differs from the inherently coercive aspect of the employment relationship, legislatures have decided, because it violates the moral norm of equal treatment in the workplace. The “good cause” exception for illness or injury stems from a normative judgment that workers should not be punished for physical problems beyond their control.<sup>105</sup> Similarly, one can base the proposed “good cause” exception for temporary work as necessary to enable UI benefits to alleviate the hardships of unemployment and to look for a new job.

Opponents will argue, however, that this proposal would exacerbate the claimant-based moral hazard problem. Under this logic, because all temporary workers can reasonably anticipate a high risk of unemployment when they accept such work, they knowingly raise the probability of their unemployment. This argument is flawed for two reasons. First, the same point can also be true about certain forms of permanent employment. Consider permanent work in industries with highly volatile consumer demand. In accepting a job in such industries, people know-

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102. See, e.g., Anthony Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472, 475-83 (1980); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413, 1442-50 (1989).

103. See *supra* note 47.

104. See *supra* text accompanying note 44.

105. That same normative judgment also drives the decision not to have a “good cause” exception for medical problems that the state deems to be self-induced. For example, several states disqualify claimants who become unemployed due to their use of alcohol or a controlled substance on or off the job, or even to their refusal to submit to a drug or alcohol test. STATE UI COMP., *supra* note 32, at 4-35 to 4-37, tbl.402, nn.15&18.

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ingly assume a high risk of unemployment in the near future. To be sure, the risk of unemployment with temporary work is more certain, since such jobs terminate upon conclusion of the fixed term or the specific project. Nevertheless, some firms offer temporary workers additional temporary assignments or sometimes even permanent work. Therefore, the risk of accepting temporary work may, in any *particular* case, be less than or equal to the risk of accepting permanent work, even though *on average* this is probably not the case.

Second, even if temporary workers raise the probability of their unemployment by accepting temporary work, requiring temporary workers to report for additional temporary job assignments only increases that probability. If a temporary worker reports for additional temporary work but refuses to accept it, the employer can use this behavior to argue that the worker “voluntarily” departed from the initial work assignment. Rather than focusing on whether a claimant accepted more *temporary* work, UI should reward persons who seek *permanent* work. UI should simply exempt temporary workers from the involuntary quit requirement and leave the work of determining which temporary workers deserve to receive UI benefits to the special moral hazard rules proposed below.

### *D. Allow Temporary Workers with a Past History of Temporary Work To Refuse To Accept Subsequent Offers of Temporary Work*

Even if temporary workers qualify for and begin receiving UI benefits, they face an additional obstacle. To avoid paying more experience-rated tax liability for their former workers who subsequently qualify for UI benefits, temporary help agencies can offer those workers additional job assignments. If the worker accepts the job assignment, then the agency faces no additional tax, because the worker has a job and can no longer receive benefits. If the worker refuses the new job assignment, however, then he runs the risk that the state UI agency will disqualify him for rejecting “suitable” work. All else being equal, most states will find “suitable” an offer of temporary work made to a person with a significant history of temporary work.<sup>106</sup>

To resolve this double bind, state UI agencies should not consider the temporary nature of a claimant’s base-period employment in determining the “suitability” of work offers. At first glance, this modification of the “suitability” test appears controversial. After all, while the “suitability” test ensures that claimants will not be forced to take jobs that make them worse off than before they became unemployed, it also prevents claimants from using UI to subsidize leisure in the

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106. See *supra* text accompanying note 57.

face of available work and from holding out for *better* terms of employment than those of work during the base period. In effect, the "suitability" test establishes base-period employment as a rough baseline against which to compare subsequent job offers. For example, a claimant may seem less credible in raising safety concerns in refusing a job offer when his base-period employment included considerable work with similar safety concerns.

By ignoring the temporary nature of jobs in the claimant's base period, UI would effectively subsidize temporary workers' job search for a better term of employment. UI would not, however, confer the same subsidy on permanent workers who, but for the "suitability" requirement, also would hold out for other *better* terms of employment. In order to justify this horizontal inequity, there has to be a special reason why the *temporary* nature of temporary work should permit temporary workers to hold out for job offers of permanent work.

Accordingly, consider two justifications for allowing temporary workers who prefer permanent work to refuse offers of temporary work. First, UI already indirectly allows claimants to hold out for better terms of employment by subsidizing training programs. Under federal law, states cannot apply UI eligibility rules "relating to availability for work, active search for work, or refusal to accept work" to deny benefits to claimants who are "in training with the approval of the State Agency."<sup>107</sup> In principle, claimants who wish to obtain better terms of employment than they can currently secure with their human capital can enter a state-approved training program. Since they can refuse work offers while in the training program, and since presumably their training enables them subsequently to obtain better terms of employment, UI effectively allows these claimants to hold out for better jobs. According to the legislative history, Congress enacted the training exception in 1970 because "in our complex industrial society, training in occupational skills had become so important to the employability of the individual."<sup>108</sup> At the time the legislation was passed, twenty-four states did not provide a way for claimants to receive UI while in approved training, "even though training is frequently necessary for obtaining new employment."<sup>109</sup> Congress did not distinguish between, on the one hand, training for a new job with terms functionally equivalent to those of the claimant's base-period employment,

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107. 26 U.S.C. § 3304(a)(8) (1994).

108. S. REP. NO. 91-752, at 48-49 (1970).

109. *Id.* at 49; *cf.* STATE UI COMP., *supra* note 32, at 1-25 to 1-27 tbl.103.



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and, on the other hand, training for a new job with different terms of employment.

In practice, however, states have not emphasized strong skill elevation, and generally have approved only “vocational and basic education training.”<sup>110</sup> Indeed, all fifty states prohibit students from receiving UI benefits if they work at the school, college, or university in which they are enrolled and regularly attend classes.<sup>111</sup> To be sure, this fact only limits the indirect subsidy to some unskilled or semi-skilled workers in training programs. Still, the fact that UI *indirectly* enables some workers to hold out for better terms of employment in and of itself does not explain why UI should *expressly* permit temporary workers to hold out for offers of permanent employment in all situations. Indeed, one might argue that if temporary workers want UI to permit them to hold out for better jobs, they should simply apply for the state-approved training programs.

One can better justify allowing temporary workers to hold out for permanent work by arguing that such a rule allow UI to cover more temporary help workers *and* reduce their repeat use of UI. Although experience-rating provides temporary help agencies with an incentive to offer another job assignment after the current job assignment ends, sometimes an agency cannot do so immediately. Thus, temporary workers may suffer unemployment for short or long intervals between temporary jobs. Since this kind of unemployment stems from the *temporary* nature of temporary work, it cannot be avoided. Thus, temporary workers who otherwise qualify for UI benefits will suffer the highest risk of any class of UI recipients of *repeatedly* using UI. This repeat use constitutes a potentially recurring and significant financial burden on the UI system.

UI currently faces this same repeat use problem with seasonal workers. All states impose special non-monetary eligibility rules on claimants who earned all or a large part of their base-period wages in seasonal employment. Seasonal has different meanings in different states. In six states, a seasonal industry or employer is defined as one in which “because of climatic conditions or the seasonal nature of the employment it is customary to operate only during a regularly recurring period or periods of less than” a specified number of weeks.<sup>112</sup>

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110. STATE UI COMP., *supra* note 32, at 4-3.

111. *See id.* at 1-6.

112. *Id.* at 3-14 to 3-15. The specified number is 16 weeks in Massachusetts, 25 weeks in Colorado, 26 weeks in Indiana and Ohio, and 36 weeks in North Carolina. In Maine, it generally is 26 weeks but is less than 26 weeks for seasonal lodging facilities, variety stores or trading posts, restaurants, and camps. *See id.* Arkansas may designate an industry as seasonal if it is cus-

Fifteen states further specify what "seasonal" means, and some states specify particular industries.<sup>113</sup> Many states count wages earned in seasonal employment only toward UI eligibility during the season, and consider off-season earnings separately.<sup>114</sup> By refusing to pool a claimant's seasonal and off-season earnings during the base period, UI disqualifies more seasonal workers for inadequate earnings, and thereby reduces the repeat use problem that seasonal workers present.

This solution, however, will not work for temporary workers. Although seasonal workers are analogous to temporary workers insofar as both work for a limited duration, temporary workers usually do not have an easily identifiable season. To be sure, retail stores may hire more temporary workers during the busy Christmas shopping period, hotels may hire extra employees for the summer months, and the tax preparation industry may hire more temporary workers during the January-April filing period. Since employers hire temporary workers in response to regularly recurring fluctuations in consumer demand, the UI system could simply categorize more industries and employers as seasonal, and apply its rules of seasonal workers accordingly. As traditional seasonal employment has declined over the long-term,<sup>115</sup> however, temporary employment increasingly cuts across all sectors the economy.<sup>116</sup> Thus, *any* industry that consistently uses temporary workers in a particular period of the year could be characterized as seasonal. The already difficult task of categorizing jobs and industries

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tomary in that industry to lay off 40% or more of the workers for as many as 16 weeks during a regularly recurring period of each year. *See id.* at 3-15.

113. *See id.* at 3-14 to 3-16. Specified seasonal industries include the first processing of perishable food, agricultural, seafood, or horticultural products (Delaware, Wisconsin), forestry, commercial fishing, hunting or trapping (Wisconsin), cotton ginning or professional baseball (Mississippi), and recreation/tourism (Minnesota). *See id.*

114. *See id.* In North Carolina, at least 25% of base-period wages must be earned in the operating period of the seasonal employer. Pennsylvania awards benefits to a worker if he earned wages in seasonal employment for fewer than 180 days of work in the season's operating period. In Arkansas, off-season wages of less than 30 times the weekly benefit amount qualify the worker for UI benefits if his or her seasonal wages come from an industry with a two- to six-month operating period. If the industry has a seven- to eight- month operating period, however, then only off-season wages less than 24 times the weekly benefit amount qualify the worker for UI benefits. Mississippi has the same rules as Arkansas, but limits the qualifying industries to cotton ginning and professional baseball. *See id.* *See generally* Rex Williams, *Seasonal Unemployment Compensation: Insurance of a Known and Certain Loss*, 4 SAN JOAQUIN AGRIC. L. REV. 75 (1994).

115. *See* Leo G. Rydzewski et al., *Seasonal Employment Falls Over Past Three Decades*, MONTHLY LAB. REV., July 1993, at 3.

116. *See* Clinton, *supra* note 5, at 4.

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as seasonal would become even more difficult and require further complicating the already dense and complex rules of the UI system.

In contrast, if UI allowed temporary workers to hold out for otherwise suitable permanent jobs, it would avoid its potential repeat use problem. Once temporary workers obtain permanent work, they will not be at as much risk of repeatedly using the UI system, because permanent work has, on average, a lower risk of unemployment. Allowing temporary workers to refuse otherwise suitable offers of temporary work not only would solve the repeat use problem but also would advance the goal of stabilizing employment. Any help that UI benefits provide temporary workers in moving into permanent work reduces the number of temporary workers and thus better stabilizes overall employment. This benefit, of course, turns on the ability of UI's moral hazard rules to distinguish between temporary workers that want otherwise suitable permanent work and those that do not.<sup>117</sup>

### *E. Adjustments to Experience-Rating*

To implement experience-rating, UI must identify “the employer”—the entity on whom UI levies experience-rated charges. When a firm directly hires a temporary worker, the firm is the employer. What happens, however, when the firm hires a temporary worker through a temporary help agency? Since the 1950s, temporary help firms have waged a lobbying campaign in the courts, state legislatures, and federal agencies to shed their legal status as “employment agencies” subject to fees and licensing requirements under state law in order to acquire the legal status as “employers” of the workers they send out to client firms.<sup>118</sup> Today, state variation on this legal question—perhaps partially reflecting the uneven success of this lobbying effort—provides a menu of policy options.

One option is for a state to designate the temporary agency as the employer and therefore require it to pay UI taxes.<sup>119</sup> This clear rule reduces administrative costs by imposing UI tax liability on the party already processing the temporary worker's other payroll information. Although the rule nominally advantages firms, temporary agencies can try to avoid the rule by misclassifying the workers as independent contractors. Moreover, experience-rating gives temporary agencies an incentive

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117. See *infra* Section IV.F.

118. See George Gonos, *The Contest over “Employer” Status in the Postwar United States: The Case of Temporary Help Firms*, 31 L. & SOC'Y REV. 81 (1997).

119. See, e.g., OKLA. STAT. ANN. tit. 40, § 2-404A(C) (1999) (stating that “[f]or the purposes of the Employment Security Law of 1980, the temporary help firm is deemed the employer of the temporary employee”); see also MISS. CODE ANN. § 71-5-11(H)(10) (Supp. 1998); TEX. LAB. CODE ANN. § 201.029 (1996).

to reassign workers as quickly as possible when one job ends. Because the proposals advanced above allows temporary workers to reject offers of temporary work, this incentive will even provide more opportunities to temporary workers who prefer more temporary work.

Another option is for states to treat the temporary agency as the employer only if the agency retains control over certain conditions of employment, including compensation and the power to discharge.<sup>120</sup> The employer—whether the firm or the temporary agency—thus has some control over the situations that enable an employee to quit for “good cause.” Of course, this opens the door for disputes between temporary agencies and their client-firms over who truly controls the conditions of employment, because both parties want to avoid UI tax liability. Although the costs of settling such disputes might be mitigated by imposing a rebuttable presumption that the client-firm is the employer or vice versa, these disputes will persist.

A third option is for states to impose joint UI tax liability on the temporary help agency and the client-firm.<sup>121</sup> Joint tax liability spreads the experience-rated tax burden in a way that a single firm or agency alone cannot.<sup>122</sup> Firms worried about their exposure to UI tax liability would shop, at the margins, for temporary agencies with lower rates of “good cause” quits by employees and with practices less likely to cause such quits. Similarly, temporary agencies would, at the margins, shy away from firms with practices that caused significant numbers of persons to quit for “good cause.” The informal market pressures of such cross-monitoring might well compensate for unequal allocation of formal control over the terms and conditions of employment, or in the alternative, encourage contracting for employment arrangements that more equally divide control. Disputes would decrease, because neither party could shift its tax liability entirely onto the other, regardless of which party has more control over the rate of “good cause” quits.

Although joint tax liability seems to be the best of these solutions, it is far from perfect. First, because employers pay for every former employee who qualifies for UI benefits, joint tax liability will exacerbate the incentive to dispute a temporary worker’s UI eligibility. Thirty-two states do not charge base-period employers if the UI agency reverses a benefit award because the claimant has violated any eligibility provision. Similarly, sixteen states will not charge the employer if the claimant is dis-

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120. *See, e.g.*, ARIZ. REV. STAT. ANN. § 23-614(E)-(G) (West 1995); CAL. UNEMP. INS. CODE. § 606.5(b)&(c) (West Supp. 1999).

121. *See* MO. ANN. STAT. § 288.032(2) (West 1993 & Supp. 1999); NEB. REV. STAT. § 48-648 (1998); N.C. GEN. STAT. § 96-8(5)(r) (1997 & Supp. 1998); *see also* R.I. GEN. LAWS § 44-30-71.4(3) (1995) (imposing joint liability if temporary agency is not state-certified).

122. *See supra* text accompanying note 69.

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qualified for refusing suitable work.<sup>123</sup> If the disqualified claimant's benefits cannot be recovered from the claimant, the amount will be deducted from the uniform account into which all employers pay the tax. Many states also exempt employers from charges for circumstances other than the claimant's violation of certain eligibility rules.<sup>124</sup> Employers will be just as likely to challenge temporary workers' eligibility as they would the eligibility of any other former employee who qualified for UI.

Second, experience-rating will exacerbate employers' existing incentive to misclassify temporary workers as independent contractors rather than employees,<sup>125</sup> because UI treats independent contractors as self-employed and disqualifies them.<sup>126</sup> A study of employer UI tax evasion found that employers in Illinois did not report 13.6% of their workers, of which employers misclassified 49% as independent contractors.<sup>127</sup> Employers already have an incentive to misclassify temporary workers as independent contractors, because most federal employment statutes cover employees, but not independent contractors.<sup>128</sup>

Meanwhile, different jurisdictions apply different tests for distinguishing employees from independent contractors. At least thirteen states employ the common law test, under which a worker is considered an employee if the person for whom he or she works has the right to control the manner in which the job is performed.<sup>129</sup> Most states, however, apply the ABC test, which presumes the worker to be an employee unless the employer proves otherwise.<sup>130</sup> Although the Internal Revenue Service defines an employee by nominally deferring to the common

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123. See State UI COMP., *supra* note 32, at 2-33 tbl.205.

124. See *id.* at 2-33 tbl.205, 2-34 nn.4 & 12. In particular, Louisiana does not experience-rate employers for benefits paid if the claimant left part-time or interim employment to protect full-time or regular employment. See *id.*

125. Employer incentives to classify their workers as independent contractors also complicates the accuracy of demographic data, because most data rely primarily on respondents' own self-identification uncorroborated by employer payroll data. It is unclear, however, to what extent a temporary worker knows that she has been (mis)classified as employee or independent contractor. As a result, existing data may underestimate the number of temporary workers who receive wages but are legally classified as "independent contractors."

126. See NELP, *supra* note 51, at 58-59.

127. See Arthur E. Blakemore et al., *Employer Tax Evasion in the Unemployment Insurance Program*, 14 J. LAB. ECON. 210, 211, 213 (1996).

128. See *supra* note 26.

129. See NELP, *supra* note 51, at 60 & n.240.

130. To prove otherwise, the employer must show that (A) "the worker is free from control and direction over the performance of her work," (B) "the work is performed either outside the usual course of business for which it is performed or is performed outside of all places of business of the enterprise for which it is performed," and (C) "the worker is customarily engaged in an independent trade, occupation, profession or business." NELP, *supra* note 51, at 61-62.

law,<sup>131</sup> it also applies a twenty-factor test to determine “control” over the manner of job performance.<sup>132</sup> Under any of these tests, the limited duration of a worker’s employment does not determine whether or not he or she has, at minimum, control over certain conditions of his or her employment. Several solutions to this misclassification problem have been proposed. These include simplifying the test for classifying workers as employees and independent contractors to make it more difficult to justify evasion after the fact, as well as increasing the penalties for failing to file a Form 1099 or filing false reports.<sup>133</sup> These solutions will be all the more important as employers try to avoid experience-rating charges for their temporary workers.

In addition to joint tax liability, successful experience-rating requires removing low-wage and short-duration exemptions. Many states will not impose experience-rated charges where employers paid employees very low wages or employed temporary workers for short periods of time.<sup>134</sup> Presumably, states use low wage and low duration exemptions to avoid administrative costs. Employers, however, have an incentive to fit their temporary hires within these exemptions to avoid experience-rating charges. To escape tax liability, employers may redefine job assignments to last for smaller time periods and then “re-hire” the same workers for another job assignment which in substance is a continuation of the previous work. The costs of this kind of tax avoidance strategy outweigh the

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131. See 26 U.S.C. § 3121 (1997) (defining any employee as “an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee”).

132. See Rev. Rul. 87-41, 1987-1 C.B. 296; see also 26 C.F.R. §§ 31.3121(d)-1(c), 31.3306(i)-1, 31.3401(a)-1 (1998); cf. *United States v. Silk*, 331 U.S. 707, 716 (1947) (noting that “degrees of control, opportunities for profit or loss, investment in facilities, permanency of relation and skill required” are important to determine a worker’s status as an employee or independent contractor). The Treasury Department admits, however, that applying the twenty-factor test “does not yield clear, consistent or satisfactory answers, and reasonable persons may differ as to the correct classification.” Quoted in MICHAEL J. GRAETZ, *THE DECLINE (AND FALL?) OF THE INCOME TAX* 79 (1997). In 1994, the House Government Operations Committee called the test “an inadequate guide to compliance with tax and other laws,” and described worker misclassification as a “pervasive and serious problem.” *Id.*

133. See, e.g., Myron Hulen et al., *Independent Contractors: Compliance and Classification Issues*, 11 AM. J. TAX. POL’Y 13 (1994); Robert K. Johnson & Stephen D. Rose, *Classification of Workers as Employees or Independent Contractors: A Proposed Legislative Solution*, 10 AM. J. TAX. POL’Y 1 (1992).

134. Some states omit charges to employers who paid the claimant less than a certain amount—Florida (\$100), South Dakota (\$100), Connecticut (\$500), Minnesota (\$500), Colorado (\$1000), and South Carolina (less than eight times the weekly benefit amount)—or who employed the claimant for less than a certain period of time—Kentucky (ten weeks), Illinois (thirty days), Virginia (thirty days or twenty-four hours), Maine (5 weeks), New Hampshire (4 consecutive weeks). STATE UI COMP., *supra* note 32, at 2-34 tbl.204, n.6. In Missouri, an employer is not charged if it employed the claimant for less than 28 days and paid him or her less than \$400. See *id.*

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administrative savings that these exemptions provide to employers and UI agencies, because employers presumably must still incur administrative costs to pay other payroll taxes from which they are not exempted.

### *F. Moral Hazard Rules for Temporary Workers*

Although not exhaustive, these proposals must be accompanied by rules to prevent newly-eligible temporary workers from using UI to subsidize their leisure activities and to limit benefits only to temporary workers who prefer permanent work. Here are two options for doing so. The first option limits the duration of benefits based on half the duration of temporary work in the base period. The second option requires claimants to prove that they are searching only for permanent work and penalizes them if they do not accept permanent work. The first option has several comparative advantages over the second.

The first option imposes the following rule: If a person becomes unemployed because of the temporary nature of his or her work and then applies for UI, that person may receive UI benefits for no more than half the duration of all the temporary work in the claimant's base period, up to a maximum of 26 weeks.<sup>135</sup> Applied properly, this rule would encourage temporary workers to self-segregate such that the temporary workers who apply for UI are, for the most part, the temporary workers who prefer permanent work. How? This rule creates an incentive for temporary workers to take several temporary jobs and jobs of longer duration before applying for UI benefits. In contrast, temporary workers who prefer temporary work have to weigh the costs of working more jobs and longer than they wanted, on the one hand, and the benefits of UI on the other hand. Under this rule, less work leads to fewer benefits. Therefore, temporary workers who prefer temporary work are, on average, better off working in the short term than applying for benefits. Although tempo-

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135. Although many states limit duration by a fraction of wages earned in the base period, a few states similarly limit duration by a fraction of weeks worked in the base period for all workers. Michigan and New Jersey limit duration to three-quarters of the number of weeks worked during the base period, but set a 15 week minimum. In Pennsylvania, a "credit week" is one in which the claimant earned at least \$50. While a claimant in Pennsylvania who has at least 16 credit weeks in the base period is eligible for 16 weeks of benefits, a claimant with at least 18 credit weeks in the base period is eligible for 26 weeks of benefits. See STATE UI COMP., *supra* note 32, at tbl.309.

When a claimant has both temporary work and permanent work in the base period, the proposed duration rule will limit the benefit duration by the fraction of temporary work in the base period. For example, if three-fourths of a claimant's base-period employment came from temporary work, one would multiply three-fourths by 26 weeks (the maximum benefit duration), arriving at a maximum of 19.5 weeks. Applying the duration rule, one would take half that time, or 9.75 weeks. Since a quarter of the base period consists of permanent work, a claimant would receive 6.5 benefit weeks (one-fourth times 26 weeks) for that employment. In total, a claimant would be entitled only to a maximum of 16.25 benefit weeks.

rary workers who prefer permanent work would have to work more temporary jobs in the short-term, they could thereby control the duration of their UI benefits, and thus how long UI would partially subsidize their job search for permanent work.

The standard economic model of a job search treats as exogenous the distribution of offered wages in the labor market and assumes that the unemployed worker will accept an offered wage if and only if it exceeds his or her reservation wage. An increase in UI benefits raises the reservation wage, and thereby reduces the probability of exiting from unemployment to employment.<sup>136</sup> Because UI pays benefits for a limited duration, however, the reservation wage of a UI recipient falls with the length of the unemployment spell until the recipient reaches the duration maximum of 26 weeks. At the same time, since UI eligibility depends on past employment, the recipient also has an incentive to find employment, particularly where the recipient faces a high risk of future unemployment, as temporary workers do.<sup>137</sup>

Under the proposed duration rule, every temporary worker who receives UI during a certain period of time trades off spending that same period of time working at more temporary jobs to qualify for a longer period of UI in the future. The proposed duration rule becomes even more attractive if we assume that job search is endogenous, that is, if we treat the probability of receiving a job offer as dependent on the amount of time or money spent on the search. Thus, even if UI indirectly reduces the probability of exit from unemployment by raising the reservation wage, it also provides more resources to temporary workers for job search and increases the probability of a more systematic search, and, with that, a successful exit to permanent work.<sup>138</sup> Moreover, this rule reduces the existing rule complexity of the UI system by replacing the virtually inexplicable distinction between the types of work classified as seasonal and those that are not.<sup>139</sup> Finally, since this duration rule does not require UI officials to verify the nature of claimant job search activity, UI saves the administrative costs of monitoring and additional eligibility verification. The price of this savings, however, is the loss of precision in screening out temporary workers who do not prefer permanent work. The reservation wage rises not only with increases in UI benefits but also with increases in the value of leisure time. Thus, temporary workers who do not prefer permanent work will have an incentive to apply for UI

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136. See Anthony B. Atkinson & John Micklewright, *Unemployment Compensation and Labor Market Transitions: A Critical Review*, 29 J. ECON. LITERATURE 1679, 1697 (1991).

137. See *id.* at 1699.

138. See *id.* at 1700.

139. See *supra* notes 112-114 and accompanying text.



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benefits if the sum of the UI benefit and leisure value is greater than the wage from available temporary work.

The second option builds upon the already existing requirement that UI recipients actively seek work and regularly provide UI officials with evidence of their job search. Under this second option, temporary workers should continue to receive benefits if and only if they prove that they currently are searching only for permanent jobs. Although Department of Labor funding limits state UI agencies' weekly eligibility screenings to under fifteen minutes a case, UI systems have, by one estimate, an 83% job-search compliance rate.<sup>140</sup> Moreover, if these workers accepted temporary work, they would have to pay back between half and all of UI benefits paid during this period, either in one lump sum or via garnishment of wages from the new temporary job. A maximum penalty should be set at the federal level—*half* of all UI benefits paid—so as to avoid an interstate race to the bottom. All the other suitability factors would remain the same.

This option, however, faces three objections: (1) problems in enforcing the job search requirement generally will enable ineligible temporary workers (those who do not prefer permanent work) to receive benefits; (2) the transaction costs of complying with the job search requirement will reduce the volume of legitimate claims filed; and (3) prospective employers typically have little incentive to incur the substantial costs of assisting UI personnel in their monitoring of claimant's job search activity. Although there is some merit to these objections, these three problems plague enforcement of UI's eligibility rules generally and not just the job-search requirement.<sup>141</sup>

There are, however, several comparative disadvantages particular to this second option. States vary in the strictness of their job-search rules. On average, claimants from states with stricter job-search rules tend to devote more hours to their searches and to contact more employers than claimants from states with moderate or lenient rules.<sup>142</sup> Because this second "job search" option requires verifying more about the claimant's

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140. See Paul L. Burgess, *Compliance With Unemployment-Insurance Job-Search Regulations*, 35 J. L. & ECON. 371, 372-73 (1992).

141. See Paul L. Burgess & Jerry L. Kingston, *Monitoring Claimant Compliance with Unemployment Compensation Eligibility Criteria*, in UNEMPLOYMENT INSURANCE: THE SECOND HALF CENTURY, *supra* note 72, at 136-72.

142. See WALTER CORSON ET AL., U.S. DEP'T OF LABOR, WORK SEARCH AMONG UNEMPLOYMENT INSURANCE CLAIMANTS: AN INVESTIGATION OF SOME EFFECTS OF STATE RULES AND ENFORCEMENT 57-87 (Unemployment Ins. Occasional Paper 88-1, 1988). *But cf.* ORLEY ASHENFELTER ET AL., DO UNEMPLOYMENT INSURANCE RECIPIENTS ACTIVELY SEEK WORK? RANDOMIZED TRIALS IN FOUR U.S. STATES 3 (National Bureau of Econ. Research Working Paper No. 6982, 1999) (finding no support for view that failure of claimants to actively seek work causes overpayment in the UI system).

past and present activity, UI agencies either would have to incur much higher administrative costs or under-enforce the requirement. In general, compliance with the job-search requirement rises with improved employment opportunities and higher wage prospects and declines with prolonged benefit duration as active job searchers exit UI and return to work.<sup>143</sup> Thus, the success of the proposed “job search” test for temporary workers will rise and fall with employment opportunities, average wages, and the duration of benefits. Moreover, the strong penalties for accepting temporary work may discourage otherwise eligible temporary workers who prefer permanent work from applying for UI in the first place.<sup>144</sup> This option for curbing the claimant-side moral hazard thus seems less promising than the first option: the duration rule.

## V. CONCLUSION

This Note has argued that UI’s existing moral hazard rules disproportionately exclude temporary workers from UI coverage, because UI sets the earnings minimums too high, treats temporary workers who complete their jobs as if they had left those jobs “voluntarily,” and does not allow temporary workers with a past history of temporary work to refuse subsequent offers of temporary work. To ensure that UI more effectively meets its original goals of providing relief for the unemployed and stabilizing aggregate employment, this Note has proposed that legislatures (1) adopt an alternative base-period definition to count a claimant’s most recent earnings; (2) lower the minimum earnings required and also use the number of hours worked to calculate eligibility; (3) establish a good cause exception for temporary workers who leave after completing their job assignments, even if they fail to report for additional temporary work; (4) remove past work history of temporary work as a factor in “suitability” analysis; (5) ensure effective experience-rating by imposing joint tax liability on both temporary help agencies and their clients and by eliminating low wage and short duration exemptions; and (6) peg benefit duration for temporary work to duration of temporary work in the base period so that temporary workers will self-segregate into those who prefer permanent work and those who do not.

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143. See Burgess, *supra* note 140, at 389-91.

144. Cf. VROMAN, DECLINE, *supra* note 31 and accompanying text. Moreover, as claimants who do apply and follow this job search requirement near the 26 benefit week maximum, they are more likely to avoid or reject opportunities for temporary work to avoid the penalty. To soften the negative effects of the strong penalties, UI agencies could waive the penalty after a certain number of benefit weeks have passed but still require claimants to prove that they were looking for permanent work. UI agencies could assess when best to waive the penalty by determining the benefit week after which claimants are statistically less likely to find permanent work.

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Concerned with temporarily alleviating the burden of unemployment and stabilizing employment, UI's founders could not have foreseen in 1935 the significant role that temporary workers and temporary help agencies would play as the century came to a close. Congress and state legislatures, however, need not be prescient to realize that as temporary workers become a more important feature of the labor market and a significant portion of the unemployed, UI must be retrofitted if it is to provide meaningful protection and relief. The proposals offered here do not exhaust the possible solutions to the problems of covering temporary workers. Nor do they begin to address the significant problems of UI that do not directly affect temporary workers. They are, instead, a first step to providing monetary assistance to a significant and growing sector of the workforce, and with that, to better attaining goals set out sixty years ago for the new century.

