Reply to Council of Economic Advisors Report "The Economic Benefits of Extending Unemployment Insurance"

Marcus Hagedorn*

Iourii Manovskii†

Kurt Mitman‡

December 10, 2013

Abstract

In December 2013, the Council of Economic Advisers and the Department of Labor released a report, titled "The Economic Benefits of Extending Unemployment Insurance." The Report contains a critical review of the research in Hagedorn, Karahan, Manovskii, and Mitman (2013) as well as of the work by Mitman and Rabinovich (2012, 2013). In this document we explain that Council's critiques are frivolous and have no scientific basis. The Report exhibits a thorough misunderstanding of basic economics and can thus only be considered a political manifesto.

*University of Oslo, Department of Economics, Box 1095 Blindern, 0317 Oslo, Norway. Email: marcus.hagedorn07@gmail.com

†University of Pennsylvania, Department of Economics, 160 McNeil Building, 3718 Locust Walk, Philadelphia PA 19104. Email: manovski@econ.upenn.edu.

‡University of Pennsylvania, Department of Economics, 160 McNeil Building, 3718 Locust Walk, Philadelphia PA 19104. Email: mitmanke@econ.upenn.edu.

1 Summary

A complete copy of Council's discussion of our research is provided in Appendix I below. Summary of our assessment of Council's arguments is as follows.

1. The statement that economic models do not imply that wages of incumbent workers respond to changes in UI generosity is false. It shows the lack of knowledge of standard economic models and of the functioning of the UI system. Strikingly, this issue is also irrelevant for what we do. The choice by the Council to emphasize this issue then either reveals a complete misunderstanding of our research or underscores the purely political nature of the Report.

2. A comment that "the model also ignores ... a dramatic spike in layoffs in late 2008" is presumably based on the Council's inability to understand our (simple) methodology.

3. Attempting to discredit our findings by accusing the Bureau of Labor Statistics of failing in its mission to measure local unemployment is ironic considering that BLS is part of the Department of Labor, a co-author of the report. Fortunately, our paper contains an explicit test validating appropriateness of these data that the Council must have overlooked.

4. The statement that Mitman and Rabinovich's work does not model the aggregate demand effects of benefit extensions, which the Council proclaims to be "the key channel through which EUC can aid economic growth and the recovery," is correct. The Council failed to understand their reason for doing so, however. Without any stimulative effects, the model in Mitman and Rabinovich fits the data nearly perfectly. The reason is clear. The estimates by the Council on the number of jobs created by such stimulus are at least an order of magnitude smaller than the number of jobs destroyed due to the negative impact of benefit extensions on job creation.

5. Other claims regarding Mitman and Rabinovich's work are simply false and presumably indicate the failure by the Council to read the paper.[1]

6. The conclusion by the Council that "Had the recent labor market recoveries been as robust in the absence of EUC as the authors find in their simulations, it is unlikely EUC would have been introduced," is nonsensical. We wish we could rely on Council's wisdom to ensure that this is so, but the quality of this Report provides us no reason for comfort.

[1] Or reading of a wrong paper? The Council neglects to add the articles it cites to the list of references at the end of the Report, so it is not clear what its odd claims are based on.

2 Detailed Reply

2.1 Summary of Hagedorn, Karahan, Manovskii, and Mitman (2013)

In response to a sharp increase in unemployment at the onset of the Great Recession, unemployment benefit duration has increased from the usual 26 weeks up to unprecedented 99 weeks. We are asking to what extent these extensions can be responsible to the extraordinarily slow recovery of the labor market afterwards.

To understand the state of the literature on the subject, note that the probability of finding a job for an unemployed worker depends on how hard this individual searches and how many jobs are available:

Chance of Finding Job = Search Effort x Job Availability

Both the search effort of the unemployed and job creation decisions by employers are potentially affected by unemployment benefit extensions.

The empirical literature cited by the Council focuses exclusively on the effect of benefit extensions on search effort. The ideal experiment this literature is trying to implement given the available data is as follows. Compare two observationally identical unemployed individuals (same age, gender, occupation, location, etc) who have different duration of benefits available. Then ask whether the individual with more weeks of benefits remaining is less likely to find a job in a given week. The existing empirical literature finds that the difference is relatively small.[2] This result suggests that search effort is little affected by benefit duration. On the basis of this finding, the literature and the Council conclude that extending benefits has no negative effect on employment and unemployment. This conclusion is unwarranted: Suppose both individuals are willing to accept the same jobs, but employers cut job creation in response to benefit extensions. Then both individuals are equally less likely to find a job. The experiment, by its very design, is incapable of capturing the effect of decrease in job creation.

We instead measure the effect of benefit extensions on unemployment and find it to be very large. The clear logical explanation for the discrepancy is that job creation declines in response to benefit extensions. Modern theory of the labor market, for which Mortensen and Pissarides received the 2010 Nobel prize, provides one possible explanation. Unemployment benefit extensions improve workers' well-being when unemployed. This puts an upward pressure on wages they demand. If wages go up. holding worker productivity constant, the amount left to cover the cost of job creation by firms declines, leading to a decline in job creation. As a consequence, unemployment rises.

[2]The Council states that we "concede" this point. This is a political statement. We have not replicated those studies and can not vouch for their findings. If the Council has reasons to believe that those studies are wrong or is aware of their criticisms, it should state them and the research community will be happy to investigate further.

Our empirical approach is based on comparing pairs of counties that border each other but belong to different states. As unemployment insurance extensions are implemented at the state level, there is a large amount of variation in benefit durations across counties within each pair. By comparing how unemployment, job vacancies, employment, and wages respond to changes in the differences in benefit durations, we uncover the effects of benefit durations on these economic variables. It is important to mention that the particular quasi-difference estimator developed in the paper takes into account that workers and firms are forward looking so that expectations about the future may affect job creation and search effort decisions today.

2.2 UI and Wages of Incumbent Workers

The first criticism of our approach by the Council is as follows:

> The model in Hagedorn et al. (2013) assumes that UI affects wages of both incumbent workers and job seekers by improving the bargaining position of workers by raising their expected income if they decline a job offer. As noted by Robert Hall (2013), however, incumbents would need to quit in order to "take advantage" of higher unemployment income and workers who quit their jobs are in fact not eligible for UI. Given this, the paper's finding that UI extensions increase wages for incumbents (Table 5) is not in fact consistent with their model or other standard models of wage determination.

This statement exhibits a lack of understanding of not only our methodology, but also basic economics:

1. *The issue of whether UI affects does or does not affect wages of incumbent workers is irrelevant for our methodology and findings.*

   We assume that the wage of a new hire will respond to future determinants, including expected changes in UI benefits, productivity, demand, etc. This assumption is clearly not controversial. It is the expected productivity, the expected wages and the expected workers' value of unemployment which matter for the firm's decision to post a vacancy.

   Consider two neighboring counties A and B with the same UI benefits and the same worker productivity in the current period but where productivity is known to increase in county A next period and to remain unchanged in county B. Benefits remain unchanged in both counties. Obviously, the current period incentives to post vacancies (create jobs) are higher in county A than in county B although current period values of benefits and productivity are identical. Our quasi-difference estimator accounts for this formation of expectations.

The same argument applies to benefits. Suppose it is expected that next period productivity remains the same but UI benefits increase in county A. This future increase in benefits negatively affects vacancy posting in county A in the current period. This happens because the workers' value of remaining unemployed increases today. In Hall and Milgrom (2008) this also increases the (newly hired) worker's payoff while bargaining.[3] This increases the wage and lowers profits and thus fewer vacancies are posted in county A in the current period. Our quasi-difference estimator accounts for this effect of expectations.[4]

Note that these arguments do not invoke the assumption that an outside option continues to be available when the incumbent worker bargains on the job. The need for the quasi-difference estimator is independent of that assumption.

2. *The increase in wages of incumbent workers is an empirical fact.*

   Our findings indicate that wages of job stayers (in the same firm in consecutive periods) do increase when benefits are extended. Quite independently of the extent of knowledge of economic theory by the Council, this is an empirical fact that the empirical strategy to estimate the contemporaneous effects of benefits on unemployment, vacancies, tightness and employment should also be consistent with, and our quasi-differenced specification is.

3. *Our finding that UI extensions increase wages for incumbent workers is consistent with our model or all other standard models of wage determination.*

   Consider, for example, the efficiency wage models that have been the workhorse model of wage setting for a number of recent decades. The central element of these models is that the effort of an employee is not fully observable and is not verifiable by the courts. Thus, if workers are dismissed, they will certainly be entitled to unemployment benefits. When the outside option of (incumbent) workers improves, they have to be paid more to exert effort. Thus, any such model has the implication that an increase in the outside option leads to a wage increase. Whether the employer pays a higher piece rate, a larger bonus or just increases the wage is irrelevant for our methodology and our results. This is so standard that even 30 years ago Lawrence Summers argued (with much consensus) during the General Discussion of a paper by Gary Burtless at the 1983 Brookings Institution that raising benefit duration puts upwards pressure on wages.

   The bargaining models that are more popular today have the same implication. Viewed

[3] A worker and a firm who start bargaining but do not reach an agreement in period t, continue bargaining in period $t+1$ and are in a bargaining situation similar to the one of a worker and a firm who meet and start bargaining in period $t+1$.

[4] To put it differently, dropping the quasi-difference estimator would yield a coefficient which is an uninterpretable convolution of the current and future county-differences in UI benefits.

through the lens of these models, our empirical finding that wages of stayers respond to benefits implies that the outside option continues to be available when the worker bargains on the job. This model of wages is certainly widely accepted as it is used not only in the standard Pissarides (2000) textbook but also in Bob Hall's prominent papers on the subject, e.g., Hall and Milgrom (2008) and even Hall (2005).

The Council seems to question this assumption by arguing that to exercise the outside option, the worker would need to quit, and quitters do not receive UI benefits. This assertion does not fully reflect reality in the U.S. labor market. In particular, it is hard to tell apart quits and layoffs and the burden of proof is on the employer. We will provide some examples below, but it is clear that many employers will not be able or willing to contest UI claims of employees. Contesting is costly even in normal times but especially during the Great Recession employers' incentives to engage in providing such evidence have been presumably negligible when benefit extensions are paid by the federal government. Our empirical findings suggest that quitters receive, at least with some probability, UI benefits. As the Council alludes to Robert Hall in making this argument (without providing an explicit reference),[5] in Appendix II we summarize the legal features of the UI system in Robert Hall's State of California that support our assertion.

2.3 Spike in Layoffs in 2008

The Council continues its critique with the following statement:

> Going beyond this inconsistency, the model also ignores important features of the recession such as a dramatic spike in layoffs in late 2008. That fact notwithstanding, the paper claims that "most of the persistent increase in unemployment during the Great Recession can be accounted for by the unprecedented extensions of unemployment benefit eligibility." Taken at face value, this suggests some omitted factor that must have changed contemporaneously with EUC extensions to offset the huge adverse employment impact those layoffs should have produced. This is highly implausible.

This is obviously nonsense. The Council simply has no idea what our paper is about. Our goal is to measure the effect of unemployment benefit extensions on unemployment. We are not making an outlandish assertion that unemployment moves only because of unemployment benefit extensions. In fact, we specifically discuss in the paper that changes in productivity, demand, taxes, food stamps program, etc, all have an effect on unemployment. In light of these many confounding

[5]Presumably the Council thought that an appeal to an unreferenced work by a living famous economist would appear more credible than citing private correspondence with the spirit of John Maynard Keynes...

factors, it is not our aim to fully separately account for all the causes of unemployment. We only ask how big is the effect of unemployment benefits extensions, and provide a precise estimate of the effect.

It is probably fair to say that early on in the Great Recession unemployment was more likely driven by a decline in labor demand that was not primarily caused by the anticipation of the unprecedented benefit extension soon to come (while we think this is unlikely, we would challenge the Council to prove otherwise). But it has been four years since the NBER Business Cycle Dating Committee, officially declared the recession over. It seems plausible, given our estimates, that unemployment benefit extensions have something important to do with the fact that unemployment is still stuck at a very high level.

And of course, we would expect more from the main economic advisors to the President than to take at "face value" a perhaps insufficiently precise statement in the abstract of our paper with no attempt to understand the (simple) economics involved. Even a superficial perusal of the text of the paper would reveal that the Council's interpretation of that statement is completely unfounded.

2.4 Council's Critique of the Bureau of Labor Statistics Data

> The empirics of Hagedorn et al. paper are also problematic. The paper attempts to isolate the effect of UI extensions by studying differences in unemployment in contiguous counties on opposite sides of a state boundary with differing unemployment benefit durations. The idea behind this research design is that the two counties will have similar populations and experience similar economic shocks, and so should have similar unemployment in the absence of policy differences. Unfortunately, the Bureau of Labor Statistics data used in the paper cannot support such an analysis since they are derived from a model that uses state level variables to predict county level employment. Thus, even if unemployment rates vary continuously across geography, measured rates will jump at the state border.

In this passage the Council questions the reliability of county unemployment data provided in the Local Area Unemployment Statistics (LAUS) program at the Bureau of Labor Statistics (which is part of the U.S. Department of Labor that is listed as a co-author of the Council's report). This is a consequential claim as had LAUS produced not genuine estimates of county level unemployment, this would be a major failure in its mission. That mission was not just to enable our research. Instead, these estimates are the basis for determining the allocation of billions of dollars in local spending under many State and Federal programs.

The procedures used by the BLS to construct county-level unemployment are certainly complex.[6] The relevant question, however, is simple: do the data provided by the BLS reflect the genuine unemployment situation in a county and are they suitable for our research design. Hagedorn, Karahan, Manovskii, and Mitman (2013) present an explicit formal test that establishes this to be the case (Sections 4.2 and 4.3 of the paper). In a nutshell, the test shows that the difference between appropriately chosen state-level variables does not predict the difference in unemployment across border-county pairs. This cannot be true if county unemployment estimated by the BLS reflected state-level variables to an important degree as claimed by the Council. We also report findings regarding vacancies and employment that come form different (administrative) sources and are not possibly subject to any mischief by the Department of Labor. These results are consistent with those regarding unemployment.

3 The Role of Aggregate Demand

The Council proceeds with a critique of a paper by Mitman and Rabinovich:

> Mitman and Rabinovitch (2012) note on the title page of their draft, available on the web, that the study is preliminary and incomplete. It is nevertheless worth noting that the nature of the methodology is such that positive effects on aggregate demand of UI and EUC are not taken into consideration, eliminating by assumption the key channel through which EUC can aid economic growth and the recovery. Furthermore, the authors do not in this early draft take into account that extensions to UI benefits come into effect only when unemployment is high, whether through the Extended Benefits automatic triggers or through legislation.

Unfortunately, it is not clear which paper the Council refers to as it neglected to cite it in the references. It would seem likely that they mean Mitman and Rabinovich (2013), which is the one the House Ways and Means Committee discussed in the statement that the Council refers to. So we assume that this is the paper the Council had in mind.[7]

Over the past several years, the Council has published numerous estimates of the number of jobs saved or created because of an increase in aggregate demand from extending unemployment benefits. The most well known prediction is reproduced in Figure 1. Why did the Council get that infamous prediction so wrong? With its single-minded focus on stimulating aggregate demand, the Council overlooked the detrimental effects of its policies on job creation by firms. Consider the

[6] An interested reader can find a publicly available detailed description in "Local Area Unemployment Statistics Program Manual," U.S. Department of Labor, Bureau of Labor Statistics, March 13, 2003.

[7] The political urgency of this Report probably did not leave time to check the spelling of the authors' names.

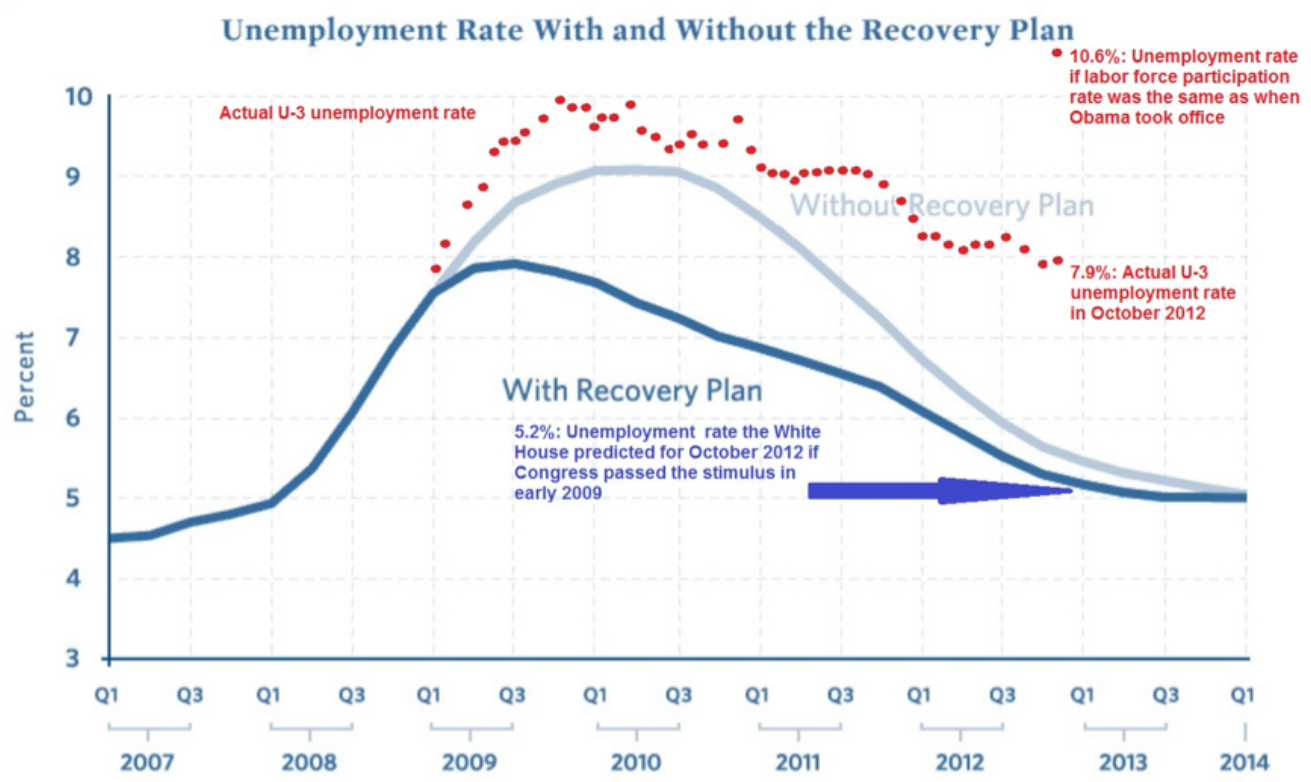

Figure 1: The Romer-Bernstein prediction with actual data superimposed by Jim Pethokoukis.

power of the simple Mortensen-Pissarides model calibrated in Mitman and Rabinovich (2013) to predict unemployment since 1960 reproduced in Figure 2. The response of job creation to benefit extensions in the model is the same as measured by Hagedorn, Karahan, Manovskii, and Mitman (2013). The model takes as given the dynamics of worker's productivity and unemployment benefit availability over time.[8] As the Council perceptively observes, the positive effects of UI extensions on aggregate demand are indeed not taken into account. Yet, the fit is nearly perfect. A moment of contemplation by the Council would reveal the reason for this: any stimulative effects of UI extensions are simply swamped by the negative effects of job creation! For example, even if the Council is right about the magnitude of demand effects, they estimate that extending EUC would generate 240,000 jobs in 2014. Based on the calculations in Hagedorn, Karahan, Manovskii, and Mitman (2013) the detrimental effect on labor demand would imply that about 2.25 million jobs fewer jobs would be created. Thus, the net effect, taking into account both channels would be 2 million fewer jobs created.

[8]The Council has obviously no idea what it is talking about when saying "...the authors do not in this early draft take into account that extensions to UI benefits come into effect only when unemployment is high..." On the contrary, the key input in the model are unemployment benefit extensions implemented exactly as in the data. That is, the dependence of benefit extensions on the unemployment rate is explicitly modeled. For example, the Extended Benefits program is modeled as an automatic trigger that depends on the unemployment rate. Thus, benefits would only be extended if unemployment increased endogenously due to a decrease in productivity.

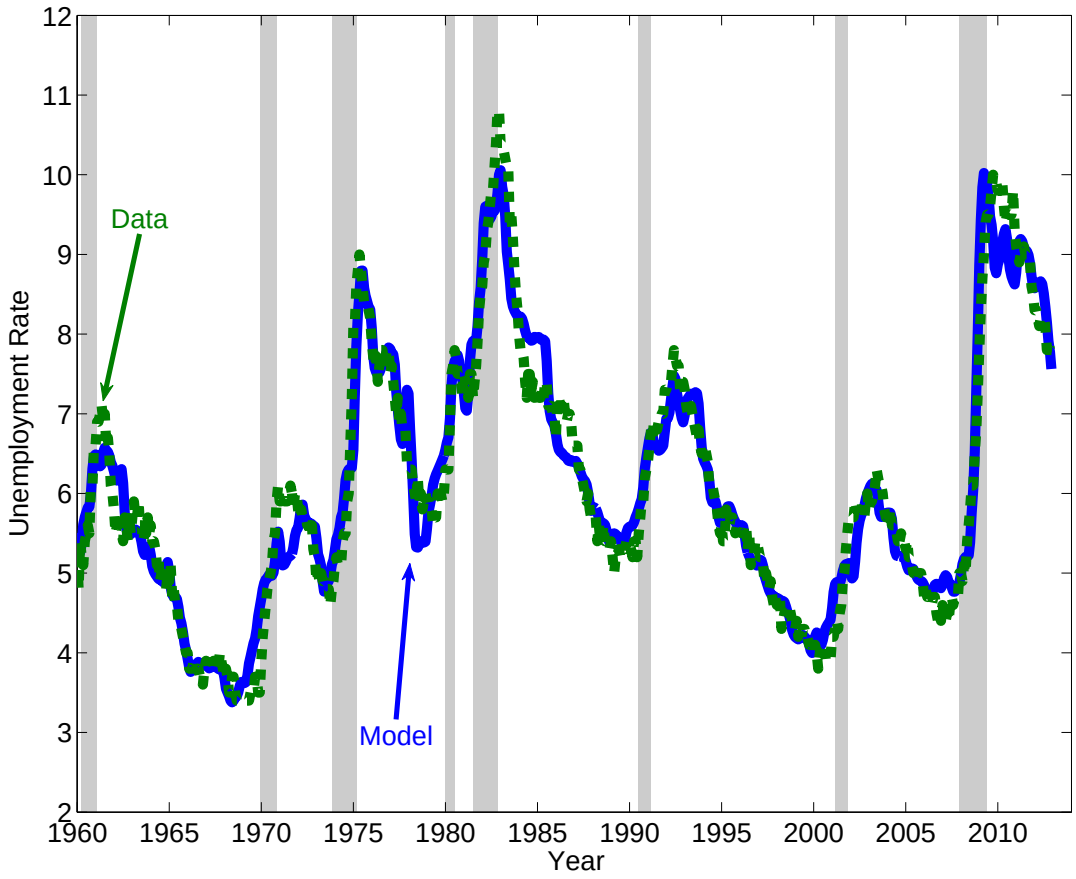

Figure 2: Actual and predicted unemployment by Mitman and Rabinovich (2013).

4 Final Thoughts

The Council concludes its critique of our work with a fascinating statement:

> Had the recent labor market recoveries been as robust in the absence of EUC as the authors find in their simulations, it is unlikely EUC would have been introduced.

One would only hope that this statement is correct. But the level of understanding of the relevant economic issues exhibited by the Council in this report gives us no reason for comfort.

Bibliography

Hagedorn, M., F. Karahan, I. Manovskii, and K. Mitman (2013): "Unemployment Benefits and Unemployment in the Great Recession: The Role of Macro Effects," NBER Working Paper 19499.

Hall, R. E. (2005): "Employment Fluctuations with Equilibrium Wage Stickiness," *American Economic Review*, 95(1), 50–65.

Hall, R. E., and P. Milgrom (2008): "The Limited Influence of Unemployment on the Wage Bargain," *American Economic Review*, 98(4), 1653–74.

Mitman, K., and S. Rabinovich (2012): "Pro-cyclical Unemployment Benefits? Optimal Policy in an Equilibrium Business Cycle Model," mimeo, University of Pennsylvania.

——— (2013): "Do Changes in Unemployment Insurance Explain the Emergence of Jobless Recoveries?," mimeo, University of Pennsylvania.

Pissarides, C. (2000): *Equilibrium Unemployment Theory*. MIT Press, Cambridge, MA, second ed.

APPENDICES

I Council of Economic Advisors Statement

"In contrast to this strong consensus among peer-reviewed studies conducted over the past 20 years, two recent working papers cited by the House Ways and Means Committee – Hagedorn et al. (2013) and Mitman and Rabinovitch (2012) – argue that recent extensions to the UI program have significantly impeded the labor market recovery after the Great Recession. The papers concede that UI benefits have only small disincentive effects on workers' search effort, but argue instead that benefit extensions discourage job creation by firms by putting upward pressure on wages, thus making job creation less profitable. This increases unemployment, they argue, since for any amount of search effort there are simply fewer jobs to be had than would have been the case had benefits not been extended.

This argument and the model it stems from have important inconsistencies. The model in Hagedorn et al. (2013) assumes that UI affects wages of both incumbent workers and job seekers by improving the bargaining position of workers by raising their expected income if they decline a job offer. As noted by Robert Hall (2013), however, incumbents would need to quit in order to "take advantage" of higher unemployment income and workers who quit their jobs are in fact not eligible for UI. Given this, the paper's finding that UI extensions increase wages for incumbents (Table 5) is not in fact consistent with their model or other standard models of wage determination. Going beyond this inconsistency, the model also ignores important features of the recession such as a dramatic spike in layoffs in late 2008. That fact notwithstanding, the paper claims that "most of the persistent increase in unemployment during the Great Recession can be accounted for by the unprecedented extensions of unemployment benefit eligibility." Taken at face value, this suggests some omitted factor that must have changed contemporaneously with EUC extensions to offset the huge adverse employment impact those layoffs should have produced. This is highly implausible.

The empirics of Hagedorn et al. paper are also problematic. The paper attempts to isolate the effect of UI extensions by studying differences in unemployment in contiguous counties on opposite sides of a state boundary with differing unemployment benefit durations. The idea behind this research design is that the two counties will have similar populations and experience similar economic shocks, and so should have similar unemployment in the absence of policy differences. Unfortunately, the Bureau of Labor Statistics data used in the paper cannot support such an analysis since they are derived from a model that uses state level variables to predict county level employment. Thus, even if unemployment rates vary continuously across geography, measured rates will jump at the state border.

Mitman and Rabinovitch (2012) note on the title page of their draft, available on the web, that the study is preliminary and incomplete. It is nevertheless worth noting that the nature of the methodology is such that positive effects on aggregate demand of UI and EUC are not taken into consideration, eliminating by assumption the key channel through which EUC can aid economic growth and the recovery. Furthermore, the authors do not in this early draft take into account that extensions to UI benefits come into effect only when unemployment is high, whether through the Extended Benefits automatic triggers or through legislation. Had the recent labor market recoveries been as robust in the absence of EUC as the authors find in their simulations, it is unlikely EUC would have been introduced."

II Elements of California Unemployment Insurance Law

We now discuss some legal details on the eligibility of workers for benefits in Bob Hall's State of California. UI policies and procedures are state-dependent but the general principles are similar. Much of the discussion is copied verbatim from the State of California Benefit Determination Guide, an eight-volume compendium, designed to present definitive discussions on points of unemployment insurance law for the field office determination interviewer.

Disclaimer. *This discussion is offered for illustrative purposes only as part of an academic discussion. It does not constitute solicitation or provision of legal advice. We are economists and not lawyers. Should the Councilors be fired for providing poor advice and nevertheless be interested in maximizing their chances of being found eligible for unemployment benefits, they should obtain legal advice from an attorney licensed or authorized to practice in their jurisdiction. This discussion is in no way a substitute for such an advice. One should always consult a suitably qualified attorney regarding any specific legal problem or matter.*

The basic line of argument in this section is as follows.

1. As a general rule, voluntary quitters are not entitled to benefits. In Section II.1 we provide examples illustrating the difficulties in establishing whether a voluntary quit has occurred.

2. In Section II.2 we explain that even if the quit is voluntary in the sense that the employer had the job available for the worker and had no intention of firing the employee, the quit may not be considered voluntary from the point of view of the Unemployment Insurance laws and regulations. If employee can argue that he had a good reason for leaving the employer, he will be entitled to benefits. We provide a small subset of such reasons that illustrate the potential for uncertainty on the part of the employer as to whether the separating employee will be able to collect benefits. This is sufficient to explain why employers accede to wage demands of incumbent workers when the generosity of the UI system increases.

3. In Section II.3 we argue that an improvement in the generosity of the UI system strengthens workers' hand in bargaining with the employer through an additional channel. Instead of the threat of outright quitting, the worker can implicitly threaten the employer to induce a firing. While workers fired for misconduct are not eligible for benefits, establishing misconduct is very difficult, in part due to the necessity of proving that misconduct was willful, and the burden of proof is on the employer. It seems likely that many employers would have little ability, resources, or economic motivation, to contest such cases in the courts. It may well be cheaper to accept workers' wage demands instead.

II.1 Was the Separation a Quit?

This is not very straightforward to establish. For example, if separation is due to mutual agreement or mutual misunderstanding the worker is eligible for benefits. In particular, when both parties have a reasonable but mistaken belief of the others understanding of the separation, the claimant is not subject to disqualification. In addition, there may be a separation by mutual agreement if the employer and the employee have mutually agreed to separate, either at the time of the termination, or initially, at the time of hire. In such cases the termination is neither a discharge nor a leaving and thus a disqualification cannot arise under Section 1256.

The following Precedent Decisions illustrate:[9]

In P-B-253, the claimant's attendance became irregular because of poor health. Her union contract provided for a leave of absence for a maximum of two years. The claimant was carried on the employer's "absent-sick service payroll" from January to March. In March the claimant contacted her supervisor, saying she was still ill and didn't know when she would be able to return. During the course of the interview, she and the employer agreed that the claimant's separation "might be the best thing to do." Neither suggested the leave continue. In its decision, the Board said:

> ...[T]he evidence before us justifies a conclusion that the conversation ... resulted in a mutual agreement between the claimant and her employer that under the circumstances no useful purpose would be served by the indefinite extension of her then existing leave of absence. Under these facts, we hold that the claimant's abandonment of the employer-employee relationship ... was with good cause... .

Some separations appear insolvable from the standpoint of a misunderstanding between the claimant and the employer, in which each thinks the other has been the moving party in the separation. In cases such as the following, the Board has considered the separation to be neither a quit nor a discharge.

In P-B-458, the claimant had been counseled concerning his job performance some five weeks prior to the separation. On the last day of his employment, he was called to a meeting with the president and general manager. At the meeting, the claimant remarked that if he were in charge he would place the blame for slow business upon himself. The president felt the claimant had not been working to capacity, and the claimant specifically recalled that the president told him they "should part company." Shortly after that, the claimant announced that he would be leaving. The claimant cleaned out his desk and left. The employer interpreted the conversation and events as a resignation, while the claimant felt he had been discharged. In its decision, the Board stated:

[9]Precedent decisions refer to the body of case law that is developed through the adjudicatory process at the California Unemployment Insurance Appeals Board (CUIAB) and contains the Appeals Board's definitive expression on unemployment matters. The Unemployment Insurance Code specifically authorizes CUIAB Board Members to consider, decide and designate as precedent decisions those cases that contain a significant legal or policy determination of general application that is likely to recur. CUIAB, its administrative law judges, and the Employment Development Department Director are controlled by these precedents, except as modified by judicial review.

> The record does not sufficiently reflect that either the claimant or the employer was the moving party. We hold that where the claimant and the employer are mutually but reasonable mistaken about the other party's understanding of the separation, the claimant is not subject to disqualification under Section 1256 of the Code.

Important Caveat. In fairness, we must admit, however, that we could not find a precedent decision clarifying how a separation upon an exogenous separation shock after 78^{th} round of Hall-Milgrom bargaining would be treated... Separation by mutual agreement or mutual misunderstanding?

II.2 Can Voluntary Quitters Be Eligible for Benefits?

As a general rule, voluntary quitters are not entitled to benefits. There are many exceptions, though, to which a worker voluntary leaving his or her job may appeal in order to receive benefits. In this section we mention some of many such reasons. The point of this discussion is that there is at least a chance, and perhaps a sizable one, that a worker might be able to collect benefits even in the event of quitting. Even on its own, this is sufficient to explain why a more generous UI system induces a higher equilibrium wage even for incumbent workers.

1. Section VQ90 A: Conscientious objection.

   When directly related to working conditions, a conscientious objection is considered to be a compelling reason for restricting availability for work or for voluntarily leaving work. Conscientious objection means an objection by an individual to performing an act that individual sincerely believes is wrong. The objection may be based on ethical, moral, religious, or philosophical grounds.

   Title 22, Section 1256-6 (b), provides:

   > ... If an individual has, or after working a time newly acquires a conscientious objection to the work condition or assigned work based on religious beliefs founded on the tenets or beliefs of a church, sect, denomination, or other religious group, or on ethical or philosophical grounds, an individual's voluntary leaving of the most recent work based on religious beliefs or other grounds is with good cause...

   The degree to which the claimant's beliefs are commonly held or considered reasonable by others is immaterial.

2. Section 1256, VQ150:

   AA. All Reasonable Transportation Alternatives Exhausted

   The claimant quit your employment because of a lack of transportation. There is no adequate public transportation available and the claimant had exhausted all alternatives before quitting. Available information shows that the claimant had good cause for leaving work.

BB. Commute Time Excessive

The claimant quit your employment because of the commute time required. Available information shows that the claimant had good cause for leaving work.

CC. Moved - No Transfer Available

The claimant quit your employment to move. He/she could not have transferred to a job site nearer to the new home. Available information shows that the claimant had good cause for leaving work.

EE. Transportation Costs Too High

The claimant quit your employment because the transportation costs were too high. Available information shows the claimant had good cause for leaving work.

3. Section 1256, VQ 155

AA. Compelling Domestic Obligations

The claimant quit your employment because of domestic reasons. Available information shows that the claimant had good cause for leaving work.

BB. Moving After Marriage - Outside Normal Commute Area

The claimant quit your employment to move with his/her spouse to a place outside the normal commute area. Available information shows that the claimant had good cause for leaving work.

CC. Moving After Marriage - No Transfer Available

The claimant quit your employment to move with his/her spouse. He/she was unable to transfer to another worksite nearer the new home. Available information shows that the claimant had good cause for leaving work.

DD. Family Illness or Death - No Leave Available

The claimant quit your employment because of a family illness/death. Available information shows that the claimant had good cause for leaving work

EE. Unemancipated Minor

The claimant quit your employment at the insistence of his/her parents. The claimant is a minor, subject to parental control. Available information shows that the claimant had good cause for leaving work.

FF. Domestic Violence Abuse - No Reasonable Alternative

4. Section 1256, VQ235

AA. Medical Advice to Quit

The claimant quit your employment on his/her doctor's advice. A leave of absence was not available or would not have resolved the problem. Available information shows that the claimant had good cause for leaving work.

BB. Reasonable Concern for Health or Safety

The claimant quit your employment because of a reasonable concern for his/her health or safety. Available information shows that the claimant had good cause for leaving work.

CC. Failure to Take Drug Test - Employer Request Unreasonable

The claimant quit your employment because he/she was asked to take a drug test. The claimant had not previously consented to the test and there was no reasonable suspicion that he/she was under the influence of drugs. Available information shows that the claimant had good cause for leaving work.

There are many, many other reasons the worker can establish that a voluntary leave was for a good cause, which we do not reproduce here. Instead, we will conclude with a couple of insightful Precedent Decisions.

In P-B-300, the claimant did establish real and compelling cause for her action. The claimant worked as a bookkeeper for a small insurance firm. She quit that employment because the employer repeatedly criticized her in a sarcastic manner in front of customers; some of the criticism was caused by errors made by the claimant in her work, but some criticism concerned matters not attributable to the claimant and some concerned matters wholly unrelated to the claimant's work. Occasionally, the claimant left the employer's office in tears. Three witnesses testified on behalf of the claimant. In finding the claimant eligible for benefits, the Board stated:

> We have held in prior decisions that a leaving of work impelled by mere dislike for a supervisor, where the facts fail to indicate a course of conduct on the part of the supervisor amounting to abuse, hostility or unreasonable discrimination, does not constitute good cause... However, the record established that the conduct of the claimant's employer in the instant case was abusive and hostile, moreover, this conduct was repeated on numerous occasions. Under the circumstances this constituted a compelling reason for the claimant to leave her employment...

Thus, if undue embarrassment, or harassment is caused by continual criticism, in contrast to a single instance of criticism, good cause for leaving does exist.

In P-B-475, the claimant worked as a secretary for a car dealership for three years. Five months prior to her leaving, the claimant was subjected to the first in a series of actions by a coworker. The coworker, who was the top salesperson for the employer, leaned over the claimant's desk, looked down her blouse and made a comment about her cleavage. She told the salesman she did not appreciate the comment, he apologized and left. Several weeks later he began to follow the claimant to her car. He continually asked the claimant if they could go to lunch together. She responded "no" twice and then ignored him. On another occasion he asked if she was wearing panties and, if so, their color. The claimant ignored these comments. A week prior to leaving the salesman purposely bumped into the claimant and knocked her into a door frame, she punched

the salesman and turned to walk away when he grabbed her buttocks. Extremely upset about the incident, she advised the owner's secretary and the owner's wife of the incident because she did not feel comfortable discussing the situation with the owner. The secretary advised the owner. The owner talked to the salesman, who admitted purposely bumping the claimant but claimed she had helped the incident along. At work the next day, the claimant asked the owner to call the salesman into the office to straighten out the situation; the owner refused, saying he felt is was a two-way street but the claimant would receive a written apology and a letter would be placed in the salesman's personnel file. On the following Monday, no further action had been taken against the salesman and she had not received a written apology. The claimant did not believe the owner would take action to stop the harassment, so she tendered her resignation. In its decision holding the claimant eligible for benefits, the Board stated:

> The issue we address is whether the salesman's conduct created an intimidating, hostile or offensive working environment for the claimant under code section 1256.7(3). The conduct in question ranged from comments about the claimant's body and undergarments to pestering the claimant to accompany him home to sexual battery. The claimant confronted the salesman twice and obtained his apology. The salesman knew that his actions were unsolicited and offensive to the claimant. In the final incident, the salesman deliberately knocked the claimant into a door frame and grabbed her buttocks. This caused the claimant to feel she was being treated like "a piece of meat" and she would never know what to expect next. Under these circumstances, we conclude that a reasonable woman in the claimant's situation would feel that the salesman's acts had created an intimidating, hostile and offensive working environment.

II.3 Was the Discharge for Misconduct?

As a general rule, employees discharged for misconduct are not eligible for benefits. Only those who were discharged not through the fault of their own are. The question we are interested in here is whether an employee can implicitly threaten the employer with misconduct during the wage bargaining. It appears that the answer is at least to some degree affirmative.

II.3.1 What Constitutes Misconduct?

For an employee to be discharged for misconduct, it has to be proven *by the employer* that misconduct was willful. Where the element of willfulness is missing, the claimant's actions would generally not be misconduct. For example, according to Section 1256-30(b)(3) of Title 22, misconduct generally does not exist, because willfulness is missing, if the claimant:

- Has been merely inefficient.
- Has failed to perform well due to inability or incapacity.
- Has been inadvertent.

- Has been ordinarily negligent in isolated instances.
- Has made good faith errors in judgment or discretion.

The following sequence of examples illustrates.

1. Example - Inefficiency 1:

   In P-B-222, the claimant was a pasteurizer for a large creamery. Prior to the claimant's discharge, there had been several discussions between the superintendent and the claimant in connection with the quality of the claimant's services. Although the claimant testified that his work improved after those discussions, his superintendent believed that the claimant had failed to improve sufficiently to warrant keeping the claimant. The principal complaint against the claimant appears to be a failure to pasteurize milk on occasions at proper temperatures and that the claimant at times held milk in the vats an excessive time, resulting in the milk acquiring an undesirable flavor. In one instance, about three hundred gallons of milk were spoiled due to improper pasteurization, resulting in a considerable financial loss to the employer. In finding the claimant eligible, the Board said:

   > A careful review of the entire evidence in the instant matter does not disclose, in our opinion, more than inefficiency or unsatisfactory performance on the part of the claimant... The record does not establish that the claimant wilfully or intentionally disregarded the employer's interest or that the occurrences forming the basis for the discharge were deliberate violations of standard good behavior...

2. Example - Inefficiency 2:

   In P-B-184, the employer hired the claimant as a production worker after the claimant indicated that he had operated drill presses, lathes, punch presses, reamers, and similar equipment. He was assigned to work a drill press and found to be unsatisfactory. He was next assigned to a lathe and was moved from that job when he incorrectly loaded a part and wrecked a fixture which required several hours to rebuild. He was, thereafter, tried on several other jobs but failed to meet the employer's standards on any of them and was discharged about three weeks after being hired. The Board found him eligible and stated:

   > The record does not establish that the claimant wilfully or intentionally disregarded the employer's interests, or that the occurrences forming the basis for the discharge were deliberate violations of standards of good behavior which the employer had a right to expect of his employee.

3. Example - Inability to Perform to Employer's Standard:

   In P-B-224, the claimant was employed for four weeks as a bookkeeper, and let go because the employer considered that her work was not "up to par." The Board found her eligible and stated:

> We find that the efficient cause of the claimant's discharge was her inability to satisfy the employer's standards in relation to the quality of her work ... mere ineptitude is not misconduct...

4. Example - Incapable of Meeting Standard:

   The claimant, a tube-bender and assembler for an aircraft manufacturer, was discharged after six years' employment because of his inability to produce an acceptable amount of work on a swaging machine. He had been assigned to this new task for only four hours when he was given a "correction interview." At this interview, he was informed that his production was 50 percent below standard and that he would be discharged unless he showed immediate improvement.

   The employer contended that the claimant had deliberately "stalled" but was unable to substantiate such a statement. The claimant had performed satisfactorily on other operations, had even been graded "excellent" in production on other tasks. When the claimant was again assigned to the swaging machine the next workday, he refused the assignment as he knew that if he did not make the quota he would be fired. He was discharged as a result.

   The claimant complied with the employer's orders when he was initially assigned to a new machine and according to the record he made every effort to become proficient in its operation. Because of his age and slight physical stature the claimant could foresee that he would not be able to operate the new machine to the satisfaction of the employer and felt justified in refusing the assignment.

   In this case the discharge would not be for misconduct. The claimant was unable to meet the employer's standards because of his age and slight physical stature. It should also be noted that the employer did not give the claimant a sufficient amount of time to meet the standards (only four hours). Likewise, if an employer should fail to provide adequate equipment for doing the work or should set quantity standards so high that only the exceptional few could meet them, a failure to produce the required quantity of work would not be misconduct.

5. Example - Error in Judgment:

   In P-B-195 the claimant, a cab driver, was discharged because of a traffic accident. At the time the claimant was hired, he received a course of instructions covering the company's rules and the motor vehicle laws with which he was expected to comply. Shortly after the end of the course, the claimant was involved in a minor accident when he backed into a parked car. He was warned that he would be discharged if involved in one more accident within a year. Several months later, the claimant was en route to pick up a passenger. He was driving approximately 40 feet behind another car, when he was hailed by someone on the left side of the street and glanced toward the person hailing him. He heard the screech of brakes, immediately looked to the front and applied his own brakes when he saw that the traffic in front of him had stopped. He was unable to stop before colliding with the car in front of him.

The collision was observed by two police officers and the claimant was cited under Section 22350 of the California Vehicle Code. The Board found the claimant eligible and stated:

> In this case, the claimant was cited under Section 22350 of the California Vehicle Code. We do not consider the fact of citation controlling in this case, but only one of the factors which we must consider in arriving at our conclusion. The quoted section of the Vehicle Code is so phrased as to allow the driver of a vehicle to exercise judgment in the operation of such vehicle. Assuming that the claimant was careless as found by the traffic officers involved, his carelessness was, at most, an error of judgment. Admittedly, it was his fault that the collision occurred. However, he was following the vehicle preceding him at a reasonable distance and erred only when he withdrew his attention from the road when he was hailed by a person on the sidewalk. It appears to us that the claimant's action could readily be defined as a reflex action in response to the call, especially since it was the practice of the taxi drivers to seek to identify such a person so that the company could be informed of a possible customer.

6. Example - Isolated Incident of Ordinary Negligence 1:

In *Silva v. CUIAB* (First Appellate Court, 1973), the claimant was being trained for new and unfamiliar work; he became nervous and frustrated and either "blew up" or felt he was going to blow up. He left work without permission in midafternoon. The employer was aware of some emotional problems the claimant was having. The employer spoke to the claimant the next morning about his unauthorized departure. The claimant's reply was sarcastic and, when told if such action was repeated he would be discharged, he responded with a vulgar remark. He was told if that was the way he felt, he could leave, whereupon he left. He would have been discharged for his attitude and language that morning had he not left. The court held:

> Given the tests of fault and wilful or wanton behavior as essential elements of 'misconduct', the single instance of an offensive remark ... uttered in the circumstances disclosed falls within the category of a mere mistake or error in judgment, a 'minor pecadillo' and is not misconduct disqualifying appellant from unemployment insurance benefits.

7. Example - Isolated Instance of Ordinary Negligence 2:

The claimant was hired to drive his employer's new cars from a freight depot to the company's storage warehouse. The automobiles were shipped directly from the factory and were serviced as they were unloaded. The employer testified that oral warnings had been given all employees to check oil and water levels before driving the cars and that any driver who subsequently caused damage to a car would be discharged.

One of the automobiles the claimant was driving incurred engine damage because the car was driven with no oil in it. The claimant denied that he had been warned to check the oil and water levels before driving the vehicles. Additionally, there was dispute as to whether the oil gage was operating correctly.

The claimant's contented that this was an "isolated" incident and that he had acted unknowingly and without evil design or intent. Because of the dispute as to the employer's warning to check oil and water levels and the working condition of the oil gage, it cannot be shown that there was wilful negligence. The discharge would not be for misconduct.

8. Example - Action Not Willful:

   In *Maywood Glass Co. v. Stewart* (1959), the claimant was discharged because she packed defective glassware on several occasions. The employer testified that she had been warned several times she would be discharged if she persisted.

   The claimant denied such warnings were given. The claimant stated she packed bad glassware because of the rapidity in which they were working. She also had a headache. The court held her discharge was not for misconduct and stated:

   > Moreover, even if the claimant had been warned, the evidence does not compel a finding that she was guilty of 'misconduct' within the meaning of the statute. Although (claimant) admitted packing defective bottles, she denied that she had intentionally done so. (Claimant) worked the 'graveyard shift' from midnight to 8 o'clock in the morning. She testified that on the night in question she was suffering from a headache and that there was a high percentage of defective glassware coming down the line. In these circumstances the trier of fact could reasonably conclude that her conduct did not constitute 'misconduct' within the meaning of the statute...

II.3.2 Burden of Proof and Presumption of Eligibility

Section 1256 of the UI Code provides in part:

> An individual is presumed to have been discharged for reasons other than misconduct in connection with his or her work and not to have voluntarily left his or her work without good cause unless his or her employer has given written notice to the contrary to the department as provided in Section 1327, setting forth facts sufficient to overcome the presumption. The presumption provided by this section is rebuttable.

In *Perales v. California Department of Human Resources Development* (1973), the Appellate court held that because the presumption in Section 1256 was established to implement the public policy of prompt payment of benefits to the unemployed so as to reduce the suffering caused thereby (Section 100 of the UI Code), the presumption affects the burden of proof. To overcome the

presumption the employer and the Department must prove that the claimant was discharged for misconduct in connection with his or her work by a preponderance of the evidence.

This is also the position in the following court decisions:

- In *Maywood Glass Co. v. Stewart* (1959), the Court stated that the employer has the burden of establishing "misconduct" to protect its reserve fund.
- In *Prescod v. California Unemployment Insurance Appeals Board* (1976), the Court held that the burden of disqualification is on the employer or the Department, and not the claimant.

The punch line: Proving misconduct is costly for the employer. And the employee can probably make it not worthwhile for many employers by threatening to drag the process out through multiple appeal procedures involving testimony and provision of documentation and witnesses by the employer.