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Unemployment Insurance: A Pathway to Restoring Solvency

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Executive Summary

The federal-state unemployment insurance (UI) programs in the United States are in a fiscal crisis. As of November 2011, the national unemployment rate was 8.6 percent, down from over 9 percent for the period of April through October 2011.¹ Although the decline in unemployment is good news, the number of long-term unemployed (those jobless for over 27 weeks) remains at 5.7 million, or 43 percent of all unemployed workers.² The unemployment rate also does not include the number of those jobless workers who dropped out of the job market and stopped seeking work, suggesting that the actual unemployment rate may be much higher.

As millions of workers seek benefits, the majority of states are unable to adequately meet those demands. Many states have underfunded their UI trust funds due to decades of low payroll taxes, which provide the revenue for these funds. Additionally, outdated UI program mechanisms, funding calculations, and benefit calculations contributed to this problem. As of December 2011, twenty-seven states and the U.S. Virgin Islands have insolvent UI trust funds, meaning that benefits owed to workers exceed the revenues used to pay for those benefits.³ However, because UI benefits are an entitlement, states must continue to provide these benefits even if their respective funds are insolvent. As a result, the states have borrowed funds from the federal government to meet their UI obligations.

Although some states have repaid their federal loan balances and others have ceased borrowing additional funds, the current balance of outstanding loans is approximately \$38 billion.⁴ Borrowing states also accrued approximately \$1.3 billion in interest payments, which were required to be repaid beginning September 30, 2011.⁵ If a state fails to pay the interest payments on schedule, the state's employers lose the ability to claim the 5.4 percent Federal

Unemployment Tax Act (FUTA) tax credit.⁶ To date, employers in Michigan, Indiana and South Carolina cannot claim full FUTA tax credits for the 2010 tax year, while employers in those states plus thirteen more will suffer reduced FUTA tax credits for 2011.⁷ As of December 1, 2011, states also have incurred an additional \$265 million in interest for FY 2012 on these UI trust fund loans.⁸ With continuing high rates of unemployment and tepid economic recovery following the most recent recession, it is expected that this pattern of state UI trust fund insolvency will continue without reforms.

However, upon consideration of the issue, both federal and state reforms on UI funding mechanisms are necessary to address both short-term insolvency and prevention of future UI depletions. To examine the varied needs of and approaches by the states, this paper examines Michigan and New Jersey, both insolvent and each affected differently by the current economy. To address short-term insolvency, the federal government should enact a moratorium on the interest payments on the loans taken out by the states to relieve the economic pressure on depleted UI trust funds and increase the federal taxable wage base. To promote long-term solvency, these reforms must be combined with forward-funding and indexing of the taxable wage base at the state level to provide consistent revenues to the UI trust funds.

1. Program Overview

1.1 History and Purpose

UI is a federal-state social insurance program in the United States for jobless individuals who meet certain criteria.⁹ UI's purpose is twofold: (1) to provide interim financial support to workers who become unemployed through no fault of their own; and (2) to stabilize the economy during economic slowdowns by providing mechanisms for smoothing income and consumption for jobless workers.¹⁰ UI benefits are designed to provide the worker with a portion of his or her previous income to help meet basic needs while seeking new employment. According to the President's Council of Economic Advisors, every dollar spent on UI benefits increases gross domestic product by \$1.60 due to the increased purchasing power of recipients.¹¹ Therefore, it is beneficial for unemployed workers to receive UI benefits not only so they can meet their own bills in a time of hardship but also because their increased spending ability boosts the economy as a whole.

UI was created in response to the economic pressures of the Great Depression as part of the *Social Security Act of 1935, U.S. Code, Title 42, §§ 501-504, 1101-1110, and 1321-1324* 2000. The UI framework is based upon federal law but is administered by the individual states through their respective departments of labor.¹² For UI purposes, a state includes all fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, making for fifty-three separate and differing UI programs. For its part, the federal government sets rules and standards for UI programs, oversees state compliance with those standards, and imposes a federal tax to help finance the programs' administration. States then create their program frameworks by setting benefit levels, duration of assistance, eligibility criteria and other means for financing the program. Thus, the states' individual UI programs vary in terms of the benefit and state tax

structure determining such issues as qualifying wage limits and work periods, the benefits paid to workers, and the payroll taxes paid by employers.

1.2 How Jobless Workers Obtain Benefits

To claim benefits, a jobless worker must file a claim with his or her state's Department of Labor.¹³ To qualify for benefits, the individual must have earned both a state-established minimum amount of wages and worked for a specified period of time. These wage levels and employment periods are known as the base period that is the foundation for that person's weekly benefit rate. The worker must also have paid into the system through payroll taxes either paid by the employee or on his or her behalf. The U.S. Department of Labor, "Employment and Training Administration," *Code of Federal Regulations*, Title 20, Part 604 (2011) requires that once an unemployed person receives benefits, he or she must re-qualify weekly for continued benefits by meeting such obligations as actively seeking work or attending job re-training.¹⁴

1.3 UI Framework

For a jobless worker's initial claim, most states provide benefits up to a maximum of twenty-six weeks.¹⁵ Under the Federal-State Extended Unemployment Compensation Act of 1970 (also known as Employment Security Amendments of 1970), *U.S. Code*, Title III, §§ 201-207, extended benefits (EB) became an additional permanent program available to states for use when there is high and/or rising unemployment. EB are available to jobless workers who have exhausted their state benefits in periods of high unemployment, providing them with between thirteen and twenty weeks of additional benefits funded both by the federal government and the states.¹⁶ However, under the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. 111-5, passed on February 17, 2009, the federal government currently bears the sole expense for EB until January 7, 2012.¹⁷ The federal government will then fully cover these claims until

June 9, 2012.¹⁸ For claims filed after January 7, 2012, the cost of extended benefits will again be funded equally between federal and state governments.¹⁹

During recessions when many states have high unemployment rates, the federal government may create and exclusively fund other temporary, emergency UI programs. The most recent program was the Emergency Unemployment Compensation program of 2008 (EUC), Supplemental Appropriations Act of 2008, Pub. L. No. 110-252 (2008), that provided an additional level of extended benefits, beyond traditional EB, to jobless workers affected by the Great Recession. The EUC provides assistance for an additional thirty-four to fifty-three weeks for jobless workers who have exhausted all other available benefits; the benefit range depends upon the level of unemployment in the worker's home state. As a result, workers in the hardest-hit states have been eligible for up to ninety-nine weeks of UI benefits.²⁰ The federal government also established the Federal Additional Compensation program (FAC) as part of ARRA that provided jobless workers with an additional \$25 per week in benefits.²¹ The FAC program was phased out as of December 2010. The EUC, however, was extended to June 9, 2012 under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312 (2010). Of the above UI programs, typically only the temporary, emergency programs are funded exclusively by federal money; all other programs require a combination of federal and state funds.

1.4 UI Program Funding

UI programs are funded by a combination of federal and state payroll taxes; only Alaska, New Jersey and Pennsylvania require employees to contribute to the system.²² Currently, the portion of payroll taxes paid to the federal government remains the same irrespective of wage levels, while states have variation in the amount of payroll taxes they collect.

1.4.1 Federal Funding

The federal payroll tax was established through the Federal Unemployment Tax Act of 1939 (FUTA), *U.S. Code*, Title 26, Chapter 23. The FUTA tax applies only to employers and cannot be deducted from employees' wages. Prior to July 1, 2011, covered employers were required to pay a 6.2 percent tax on the first \$7,000 of each employee's annual wages. For purposes of FUTA, an "employer" is defined generally as an employer who (1) paid wages of at least \$1, 500 per calendar year, or (2) employed at least one individual for some portion of the day on at least 20 days per calendar year.²³ So long as an employer meets the above criteria, he or she must pay the FUTA tax on all employees, whether full-time, part-time or temporary workers. On July 1, 2011, the FUTA tax dropped to 6.0 percent.²⁴ FUTA also provides a tax credit of up to 5.4 percent to employers who timely pay state taxes under an approved state UI program.²⁵

As a result, the U.S. Department of Labor reports that employers pay an effective tax rate of 0.8 percent, or a maximum of \$56 per employee, per year, which recently dropped to a 0.6 percent tax rate with the FUTA rate reduction. This tax rate applies irrespective of the wages ultimately earned by an employee. It is therefore regressive because it applies in greater proportion to those earning less income.²⁶ FUTA revenues are placed in the federal Unemployment Trust Fund (UTF) and are used to fund: (1) all federal and state administrative

costs of UI programs; (2) the federal share of EB; and (3) UI benefits to former federal employees.

The federal government may also provide loans to the states if their UI trust funds are unable to meet their benefit obligations.²⁷ To ensure repayment of the loan, the federal government requires that the full loan amount be repaid by November 10 of the second consecutive year of the outstanding loan balance.²⁸ Because UI benefits are funded through the payroll tax, if the loan is not paid in full, the federal payroll tax is increased for each subsequent year for which the loan remains unpaid in order to increase revenue. The states also receive a 0.3 percent annual reduction of the FUTA tax credit for every year that the federal loan remains unpaid.²⁹ Additionally, states must pay interest on the balance owed at the lesser rate of either 10 percent or the rate at which interest was paid on the state reserve balance for the federal UI trust fund for the last quarter of the preceding calendar year.³⁰ The federal government prohibits repayment of these loans and their interest from the states' UI trust funds.

1.4.2 State Funding

Because the states control the design of their UI programs, they also control the tax structure funding them.³¹ State UI programs are designed to be forward-funded, whereby trust fund reserves are built up during times of growth to meet the demand for UI benefits in economic downturns.³² State revenues come from payroll taxes based upon the amount of annual wages per employee that is subject to taxation, known as the taxable wage base.³³ According to the U.S. Department of Labor, forty-six states have taxable wage bases higher than the \$7,000 base upon which the FUTA is calculated. As of the end of 2010, the average state taxable wage base was \$15,261 per year with an average tax rate of 2.82 percent.³⁴ Even so, state payroll tax rates have been on the decline.

1.5 History of State UI Trust Fund Solvency Issues

Although the Great Recession, which began in 2007, highlighted these issues, state UI trust fund solvency has been in question for decades.³⁵ The Government Accountability Office (GAO) found that the average year-end UI trust fund reserves dropped from a typical 5.1 percent of total wages for the period of 1938 to 1973 to 1.0 percent of total wages for the period 1974 to 2008. Additionally, state UI tax contributions have trended downward from an annual average of 1.15 percent of total wages in 1979 to 0.65 percent in the period from 1998 to 2008. Over this same period, state UI benefits rose slightly, so the amounts paid out exceeded the UI revenues coming in. These conditions led to the erosion of state UI trust fund reserves heading into the Great Recession.

The GAO attributed these eroding state UI trust fund reserves to several state policies. First, most states do not index their taxable wage bases to inflation or wage growth.³⁶ As a result, employers are paying a declining tax even as wages for employees have increased over the preceding decades. The GAO found that those states indexing their taxable wage bases increased their UI trust fund reserves and had less risk of future insolvency.³⁷

Another key policy leading to the deterioration of state UI trust funds has been low payroll taxes, which are the main basis for funding UI benefits. The GAO cited a 2009 U.S. Department of Labor study that reported that all but six states levied average tax rates below those necessary to cover benefits and maintain state UI trust fund solvency. Lastly, the GAO found that UI benefits remained fairly flat from 1979 to 2008, so overly generous benefits are not the source of state UI trust fund insolvency.³⁸

The state UI trust fund crisis also cannot be blamed upon the specter of low-wage workers defrauding the system. The GAO reported that although low-wage workers were twice

as likely to be unemployed, they were only half as likely to receive UI benefits despite having payroll taxes paid on their behalf.³⁹ In fact, the GAO found that “states with declining or insolvent trust funds were likely to make it more difficult for unemployed workers to qualify for benefits and to reduce the portion of wages of former workers replaced by unemployed benefits” because stringent restrictions and reduced benefits soften the financial hardship upon reduced and strained state UI trust funds.⁴⁰ These conditions created a perfect storm whereby state UI trust fund reserves took a significant hit once the Great Recession increased the numbers of jobless workers.

2. UI in the Great Recession

The National Bureau of Economic Research determined that the Great Recession ended in the second quarter of 2009, but unemployment, a lagging economic indicator, persisted. The national unemployment rate began increasing in late 2007 but did not top 9 percent until May 2009, the end of the official recession. The national unemployment rate currently is 8.6 percent.⁴¹ Experts predict it will average more than 8 percent until at least 2012 due to continued anemic job growth.⁴²

The depth and length of the economic downturn helped set a number of dubious UI records. In 2010, the average UI recipient collected benefits for twenty weeks, an all-time high. The portion of jobless workers collecting UI relative to the number of covered employees nationwide rose to its highest level since 1982. The result of these record-breaking benchmarks is that states paid more than \$71 billion in UI benefits in the federal fiscal year that ended September 30, 2010.⁴³

2.1 Effects of the Great Recession on States' UI Systems

Although the U.S. Department of Labor encourages states to maintain their UI trust funds at a level that would support one year's worth of payouts "equal to the average of the three highest payout periods in the last twenty years," many states had underfunded their trust funds in the years preceding the Great Recession.⁴⁴ As a result, as of December 1, 2011, twenty-seven states and the U.S. Virgin Islands have insolvent UI trust funds. Many states have turned to the federal government for help paying their UI bills. As of December 1, 2011, the outstanding balance owed by the states for federal loans to their UI trust funds totaled more than \$38 billion. States' continued borrowing through 2013 is projected to increase to \$65.2 billion, far more than has been borrowed in any prior recession (see Appendix A: Comparison of State Unemployment Insurance Funds).⁴⁵ Although ARRA waived interest due on the loans through December 31, 2010,⁴⁶ as of September 30, 2011, states had to begin repaying over \$1.3 billion in interest or face consequences such as FUTA tax credit reductions. These states are required to timely make their interest repayments, although they cannot utilize their UI trust funds to do so. A number of states have turned to, or are considering, issuing bonds to repay the loans and related interest.

States must also refill their UI coffers. In many states, replenishing UI trust funds will come in part from higher UI taxes on employers, due to automatic triggers that increase taxes in reaction to declining trust fund reserves. In 2010, at least twenty-five states increased their taxable wage bases, which translated to higher taxes on employers.⁴⁷ When other tax changes are considered, thirty-six states increased taxes on employers in 2010.⁴⁸ Contrarily, as of August 2011, only Colorado and Rhode Island increased their taxable wage bases for 2011.⁴⁹ Instead, states found another, temporary source of additional UI funding.

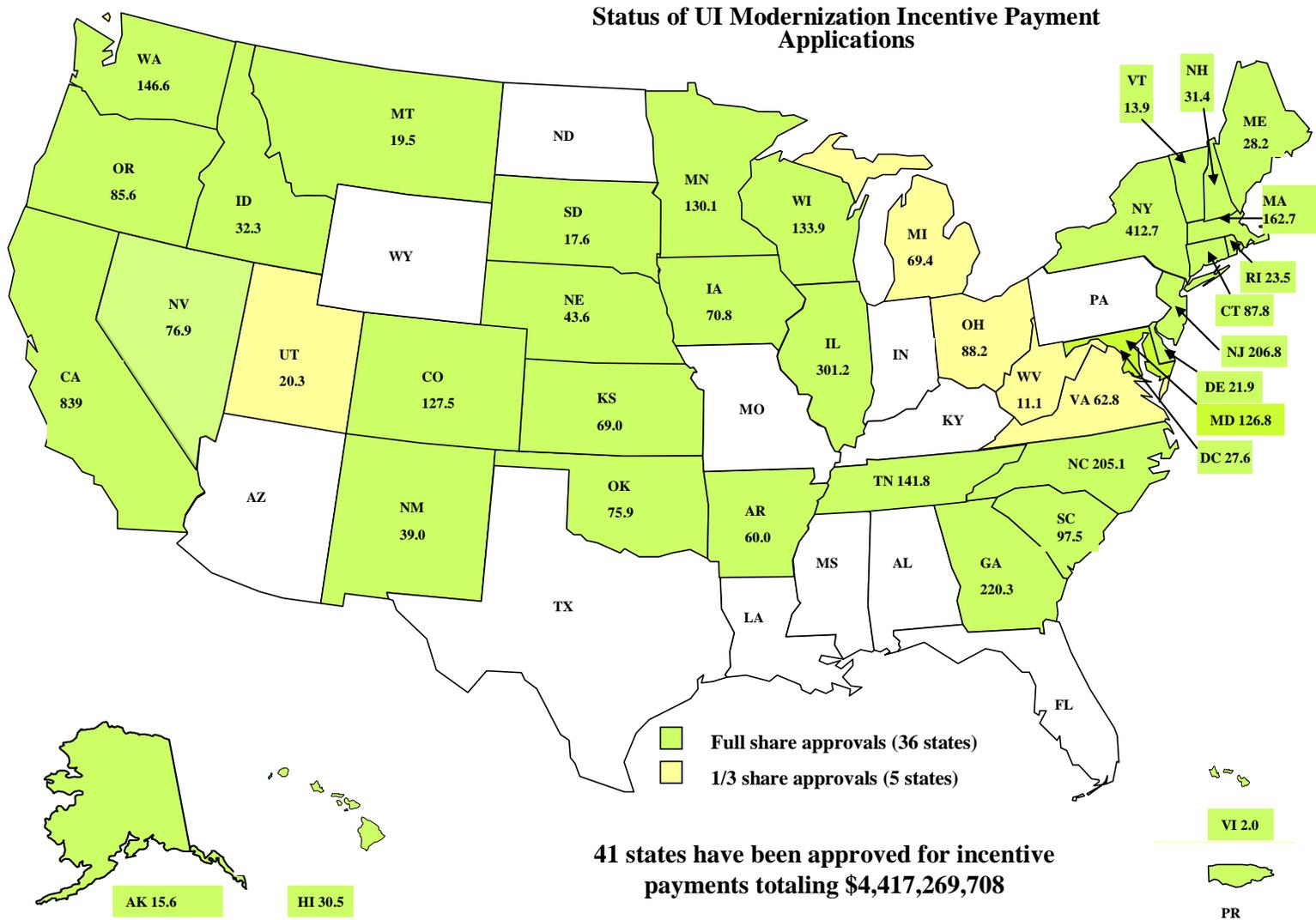
In addition to establishing the EUC and FAC payments and granting states a reprieve on their federal UI loans through ARRA, the federal government used the 2009 stimulus to make \$7 billion available for modernization incentive distributions to states whose UI programs met certain eligibility criteria.⁵⁰ The purpose of the modernization incentives is for states to close the gaps in their programs that deny benefits to large numbers of workers while also improving the administration of their programs.⁵¹ By providing the states with immediate funds while also providing UI benefits to lower-income workers who previously would have been ineligible, modernization funds are seen as a way to address current short-term UI problems while also reforming the system to address future recessions and fiscal sustainability.

To qualify for the first one-third of federal funding, a state must adopt the alternative base period, which permits a jobless worker to use his or her recent earnings as well as previous earnings if doing so would help that worker obtain UI benefits. The reason behind the alternative base period is to reach the significant percentage of workers, such as seasonal, part-time, or low-income workers, who otherwise would be unable to qualify for benefits due to insufficient wages. To receive the remaining two-thirds of funds, a state must provide benefits in two of the following four categories: “(1) part-time workers who are denied state benefits because they are required to seek full-time work; (2) individuals who leave work for specific compelling family reasons, including domestic violence; (3) workers with dependent family members who qualify for state benefits but whose benefits should be increased to help care for those dependents; and (4) permanently laid-off workers who require extra benefits to participate in job re-training.”⁵²

States had until August 22, 2011 to apply to the U.S. Secretary of Labor to have their laws certified as compliant with the modernization provisions. The applicant states received federal modernization funds only upon certification, and each state was then required to

implement its qualifying reforms within one calendar year.⁵³ As of September 14, 2011, thirty-six states claimed all modernization funds available to them, but five states claimed only the first one-third available and nine states did not claim any federal modernization funds.⁵⁴ Figure 1 below provides a map of those claiming full and partial ARRA modernization payments.

Figure 1. State of UI Modernization Incentive Payments.



Source: National Conference of State Legislatures, "State Incentive Payment Chart." Last modified September 14, 2011. http://www.ows.doleta.gov/unemploy/docs/app_form.doc (accessed 4 Dec. 2011).

3. State Case Studies

As described earlier, states' UI systems differ widely. For example, in 2010, states' average weekly benefit payout ranged from a low of \$189.87 in Mississippi to a high of \$416.17 in Hawaii, with an average payout of \$289.46.⁵⁵ The following analysis takes a closer look at the UI systems and conditions in Michigan and New Jersey. These states were selected for examination because both have been hard hit by the Great Recession but have diverse state economies and characteristics.

Figure 2. States at a Glance: UI Program Statistics

| State | Insolvent | Federal Loan Balance* | Taxable Wage Base** | Average Weekly Benefit** | Unemployment Rate*** |
|--------------|------------------|------------------------------|----------------------------|---------------------------------|-----------------------------|
| Michigan | Yes | \$3,152,239,816.84 | \$9,000 | \$287.58 | 10.6 |
| New Jersey | Yes | \$1,323,302,821.41 | \$29,600 | \$395.59 | 9.1 |

Sources: * U.S. Department of Labor. Trust Fund Loans. Last modified December 1, 2011.

<http://ows.doleta.gov/unemploy/budget.asp#tfloans>.

** U.S. Department of Labor. Significant Provisions of State Unemployment Insurance Laws Effective July 2011.

<http://ows.doleta.gov/unemploy/content/sigpros/2010-2019/July2011.pdf>.

***U.S. Department of Labor, Summary Data for State Programs, by State. Last modified December 3, 2011.

<http://ows.doleta.gov/unemploy/5159report.asp>.

****U.S. Bureau of Labor Statistics. Local Area Unemployment Statistics. Last modified November 22, 2011.

<http://www.bls.gov/web/laus/lausthl.htm>.

3.1 Michigan

Michigan's economy entered a recession in 2001 and has not yet emerged. Due in large part to the failures of the auto industry, the state lost approximately one million jobs between 2000 and 2009. One-third of these jobs were lost in 2009 alone, more than 268,000 of which were from the auto industry.⁵⁶ The state's current unemployment rate of 10.6 percent is down from its peak of 14.1

percent in August-September 2009, but still ranks as the fifth-highest unemployment rate nationwide, an unfortunate honor also shared with Mississippi.

Michigan does not index its taxable wage base. At \$9,000, it is just \$2,000 more than the minimum level mandated by FUTA. Michigan was the first state to have an insolvent trust fund, having begun borrowing from the federal government in September 2006.⁵⁷ To date, Michigan has borrowed nearly \$4 billion in federal loans, putting it second only to California, a state with more than three times as many residents. Due to its failure to timely pay its current interest payments, Michigan employers will lose part of the state's FUTA tax credit for 2011,⁵⁸ and it likely will undergo another FUTA credit reduction for 2012.⁵⁹ The likelihood of Michigan repaying its federal UI loan balance and interest in the near future looks bleak: Michigan has incurred almost \$22 million in interest on these loans for FY 2012, currently second only to the amount owed by California.⁶⁰

On March 28, 2011, Michigan Governor Rick Snyder signed into law a controversial bill that cut UI benefits to jobless Michiganders. The bill cut the maximum period a person can receive UI benefits from twenty-six weeks to twenty, the lowest amount in the country; residents would still remain eligible for federal benefits that extend their UI benefits. Michigan was the first state to initiate this benefit reduction. The change means that employers will pay less in UI taxes in 2012, as much as \$600 million less, according to both the state's Republican-led legislature and the Michigan Chamber of Commerce.⁶¹

In May 2011, the Lucas Group, a consulting firm, released a study sponsored by the Michigan Chamber of Commerce on the bankrupt Michigan UI system. To return Michigan's UI trust fund to solvency, it recommended updating monetary eligibility requirements and benefit formulas, increasing work search requirements, and increasing fraud identification and recovery.⁶²

Although the study was self-described as non-partisan, it should be noted that it did not favor increased business taxes, a position supported by the Michigan business community that sponsored the study.

3.2 *New Jersey*

New Jersey's residents are strongly affected by their proximity to Philadelphia and New York City, both major urban centers. Former Governor Jon S. Corzine estimated that Wall Street supports approximately one-third of New Jersey's economy due to the significant number of residents working in the financial sector. Moody's estimates that financial services make up one quarter of the state's annual GDP.⁶³ This reliance on Wall Street left the state reeling in the economic downturn starting in 2008. The state's unemployment rate peaked at 9.7 percent in March 2010 before falling slightly, and it remains above 9 percent. In Fiscal Year (FY) 2010, the state's UI fund collected \$2.2 billion and paid out \$3.4 billion in benefits to 564,000 jobless residents.⁶⁴

New Jersey appears to be in somewhat better shape in terms of possible UI funding streams than some other states. It is just one of three states where employees contribute to the UI system, and it indexes its taxable wage base of \$29,600, the sixth-highest nationwide. However, those factors have not prevented the state's trust fund from reaching insolvency. New Jersey began borrowing from the federal government to pay its UI bills in March 2009.⁶⁵

As part of a bill halting an automatic UI tax increase, current Governor Chris Christie created a task force to examine the state's UI system. The group attributed some of the insolvency to two causes: diversions in recent years of \$4.6 billion from the UI trust fund and adjustments to the state's UI tax tables within the previous decade. Those changes narrowed the bands used to determine employer tax liability and consequently led to greater volatility in the revenues accumulated by the UI system.⁶⁶

By current state law, the trust fund's insolvency will trigger a UI payroll tax rate increase, costing an average of \$300 per employee each year and an additional assessment to repay the federal loan principal. The state is also among those due to lose the 0.3 percent FUTA credit. In its first report in February 2011, Governor Christie's task force recommended two steps to help restore solvency to the state's trust fund: (1) to phase in the employer tax increases over three years to ease the related potential economic shock; and (2) to restore the broader UI employer tax bands that were in place in 2003.⁶⁷ The task force will continue to consider options aimed at restoring UI solvency over the next two years.

4. Policy Options

UI programs' insolvency is a major concern for the future of a social policy that has proven critical to both participants and the economy. Building toward a sustainable, solvent system will require a combination of federal and state policy changes.

4.1 Federal Options

Generally, the federal government's policy options are limited due to the greater control given to the states over their UI programs. However, the federal government recently began considering options designed to reform the federal and state contributions to the UI system, although as of Fall 2011, no legislation has been taken up. The purpose of these reforms is to both alleviate the fallout from the Great Recession and create long-term solvency of UI trust funds.

4.1.1 Proposal from Obama Administration and Congressional Democrats

In February 2011, President Obama released his budget for FY 2012, in which he outlined proposed UI changes. The Administration's proposal included an extension of interest-free

borrowing for state UI trust funds for two years, a moratorium on state payroll tax increases in FYs 2011 and 2012, and raising the FUTA taxable wage base from \$7,000 to \$15,000 beginning in 2014.⁶⁸ Although the states have taken steps to increase their own taxable wage bases, the federal UI taxable wage base has not been adjusted since 1983. To avoid a federal tax increase, the federal tax rate on the new, higher taxable wage base would be adjusted downward. President Obama's proposal would cost approximately \$5 billion and the cost would be offset with future revenue collections due to the increase in taxable income levels.

Shortly after the President announced his proposal, Senators Dick Durbin (D-IL), Jack Reed (D-RI) and Sherrod Brown (D-OH) introduced a similar plan in the *Unemployment Insurance Solvency Act*, S. 386, 112th Cong., 2011.⁶⁹ Introduced on February 17, 2011, the draft legislation, like the budget proposal, increases the federal taxable wage base from \$7,000 to \$15,000 beginning in 2014. The bill also would suspend interest payments on state UI loans for two years and keep states from raising taxes on employers through automatic triggers. Lastly, the bill offers incentives to states to maintain solvent UI trust funds, including reduction of the FUTA tax and interest rate increases on state trust funds held by the U.S. Treasury. As of December 2011, the draft legislation has been referred to the Senate Committee on Finance, but no further action has been taken.

The Unemployment Insurance Solvency Act has garnered support from groups such as the National Employment Law Project (NELP). Christine Owens, NELP's executive director, stated, "[T]he introduction of the Unemployment Insurance Solvency Act sets the stage for a serious conversation on how to make sure that the safety net that tens of millions of Americans have counted on during the tough times of the last few years will be financially secure into the future."⁷⁰ Key Republicans in Congress quickly opposed the bill based upon the increase in the taxable wage base and a lack of reform of UI programs. However, taking states with indexed taxable wage bases and the 2010 GAO report findings together, there is a demonstrated correlation between higher

taxable wage bases and state UI trust fund solvency. Furthermore, the moratorium on the states' impending interest payments would provide the states with short-term relief in order to implement reforms to bring about UI trust fund solvency.

4.1.2 Proposal from Congressional Republicans

On May 5, 2011, Senator Orrin Hatch (R-Utah) and Representative Dave Camp (R-Mich.) introduced bicameral legislation colloquially referred to as the JOBS Act of 2011. The two pieces of legislation are formally known as the *Jobs, Opportunity, Benefits and Services Act of 2011*, HR 1745 and S. 904, 112th Cong. (2011). The proposed legislation would impose restrictions on jobless workers seeking UI benefits and provide flexibility to states in how to utilize federal UI funds they receive.⁷¹ The bills restrict UI eligibility to those who either have or are satisfactorily obtaining a high school diploma or GED. They also require all states to reduce current UI benefits to recoup prior UI benefit overpayments. Lastly, the joint legislation “forward funds” federal UI funds to states for FYs 2011 and 2012 that can be spent on a variety of measures, such as current UI benefits, repayment of a state’s federal UI loans due to insolvent trust funds, or job creation programs.

Proponents of the legislation argue that higher payroll taxes will stunt job growth and hiring, and that the flexibility in the use of federal UI funds allows the states to determine how best to stabilize their UI trust funds.⁷² They also argue that the flexibility allows states to address their unique unemployment issues, whereas current law utilizes federal funds for EB for jobless workers. Opponents, however, view the JOBS Act as an attack on already-vulnerable jobless workers. Representative Sandy Levin (D-Mich.) called the legislation a “hatchet job on the unemployment insurance program.”⁷³

There also are concerns that such flexibility would allow states to continue practices that led to insolvency. Under the JOBS Act, states could use federal funds to reduce their payroll taxes,

further depleting the revenue in their UI trust funds. Compounding this problem is that by reducing UI benefits, jobless workers would have less money available to support the economy through consumer purchases. The progressive think tank Center for American Progress called such consequences “the kind of moral hazard one would think the Republicans would want to avoid.”⁷⁴ As of December 2011, the two proposed bicameral bills encompassing the JOBS Act have been placed on the House Union Calendar and referred to the Senate Committee on Finance, but no action has been taken since May.

4.2 State Options

For the past twenty-five years, fewer than half of jobless workers collected UI, except during recessions.⁷⁵ Therefore, most states do not keep enough money in their trust funds to cover payouts for every jobless worker, and when economic downturns occur there are emergency measures that are enacted.

4.2.1 Cutting Benefits

Some of the cash-strapped states that are facing impending interest payments are looking to cut UI benefits in order to restore UI trust fund solvency. As of December 2011, Arkansas, Florida, Illinois, Michigan, Missouri and South Carolina have reduced the maximum number of weeks jobless workers can receive benefits from twenty-six to between twenty and twenty-five weeks.⁷⁶ In September 2011, the Michigan Legislature began consideration of bills designed to further reduce UI benefits within the state.⁷⁷ These states’ current unemployment rates range from 8.2 percent to 10.6 percent.⁷⁸

State governments are motivated by the need to replenish depleted state UI trust funds as well as the position that long-term collection of UI benefits provides disincentives for the unemployed to return to the workforce. These benefit-cutting bills also reduce payroll taxes on

employers, a motivating factor for Florida legislators.⁷⁹ Opponents of such legislation, however, reflect the same concerns as those opposed to the JOBS Act of 2011. A November 2010 report by the U.S. Congress Joint Economic Committee concluded that if the federal government cut off EB prematurely, for example, approximately \$80 billion worth of purchasing power would be drained from the economy and would result in the loss of an additional one million jobs over the course of a year.⁸⁰

4.2.2 UI Financing: Forward-funding versus Pay-as-you-go

There are generally two policies employed by both the states and the federal government to finance UI programs: forward-funding and pay-as-you-go. As discussed previously, forward-funding is the mechanism best suited to the counter-cyclical nature of UI programs. Alternatively, pay-as-you-go financing keeps UI payroll taxes and trust fund levels as low as possible during good economic times and raises taxes and cuts benefits due to financial stress during recessions.⁸¹

Although UI programs were intended originally to be forward-funded for economic stability, pay-as-you-go has become increasingly common.⁸² The proposed JOBS Act and state actions such as those in Michigan and Florida reflect the pro-business philosophy underlying pay-as-you-go funding. At its most simplistic, it reflects a conservative viewpoint that reducing payroll taxes will encourage more businesses to hire workers.⁸³ Proponents also point to the short-term benefits of employers and employees having more money that they can then put back into the economy through consumer spending. However, studies predominately show that despite its popularity, pay-as-you-go funding is actually bad public policy. In their study, Ernest Goss and James Knudsen wrote:

Under a pay-as-you-go system, the state may have to impose higher taxes on employers during downturns in the economy, just when employers are less able to pay the UI taxes. Alternatively under a pay-as-you-go system, states could reduce UI benefits during an economic downturn, again reducing overall consumer demand and potentially prolonging the economic recession.⁸⁴

Critics have also opined that higher taxes are not the reason employers are not hiring in the current economic downturn. *Fortune* magazine recently acknowledged that large, publicly-owned companies actually are “sitting on nearly \$2 trillion in cash and other liquid assets.”⁸⁵ Furthermore, Moody’s Analytics Chief Economist Mark Zandi said that businesses do not respond to tax holidays because of their temporary nature.⁸⁶ Instead, pay-as-you-go and its accompanying payroll tax cuts actually take money out of the economy. For these reasons, pay-as-you-go funding violates the counter-cyclical purpose legislators intended at UI’s inception.

4.2.3 Index Taxable Wage Base

As discussed earlier, the taxable wage base is the portion of annual employee wages that are subject to payroll taxes that fund UI trust funds. Indexing is the automatic annual adjusting of taxable wage bases in conjunction with growth in wages that helps maintain a positive balance in states’ UI trust funds. Currently, seventeen states index their taxable wage base to nominal wage growth, which enables “the wage base to broaden without ongoing legislative action.”⁸⁷

According to NELP, the best way to meet both immediate and long-term needs is to raise and index the taxable wage base used for calculating unemployment taxes.⁸⁸ Arguments in favor of indexing the wage base include the ability for states to keep their program financing in line with UI benefit growth and the ability to continually prevent depletion of UI trust funds to the point of insolvency.⁸⁹ Without indexing the wage base, “a state must finance higher benefit payments on a narrower portion of its wages.”⁹⁰

Opponents to indexing the taxable wage base equate it to increasing employer taxes.⁹¹ The declining overall tax rates for employers funding state UI trust funds indicate that this view has some hold in state legislatures. The GAO’s 2010 report bears this view out: only seventeen states

had indexed taxable wage bases, and the remaining states either did not index their taxable wage bases or did so sporadically and infrequently.⁹² However, research demonstrates that UI systems in states with indexed wage bases maintained higher annual trust fund reserves and had fewer instances of trust fund insolvency.⁹³ Therefore, continually adopting a low-tax view places the states at risk of continued fiscal deterioration and UI trust fund insolvency.

5. Policy Recommendations

Upon examination of historical and current UI trust fund practices as well as some of the options currently discussed, it is clear that the best approach to short-term and long-term UI trust fund solvency involves integrated federal and state reforms.

To provide immediate short-term relief to the states, the federal government should enact the moratorium on interest repayments on federal loans. This would relieve some of the financial pressure on insolvent states while providing them with a window during which to begin reforms to their UI programs and state UI trust funds. Because UI policy largely is dependent upon variances among the states, long-term UI trust fund insolvency will hinge upon state reforms. As research from a variety of sources has shown, if a state UI trust fund is to avoid insolvency, there must be a system of wage indexing and a policy of forward-funding in place.

Although forward-funding fell out of favor with many states, the designers of UI programs intended it to be the funding basis for the system. It provides economic stability by increasing state UI trust fund revenues in times of growth in order to provide the necessary benefits in times of recession without increasing fiscal demands on the states through such things as federal loans for insolvent trust funds. Wage indexing also is a critical component to overall state UI solvency and must be implemented at both the federal and state levels. Indexing permits the financing of UI

programs to keep pace with the insured risk (i.e. loss of wages).⁹⁴ UI financing experts have found that states with higher taxable wage bases have better UI trust fund solvency and enhanced ability to raise revenues for UI trust funds when UI benefit claims numbers rise.⁹⁵ In addition, the federal Advisory Council on Unemployment Compensation, first convened in the early 1990's by former President George H.W. Bush, found that increasing state taxable wage bases were associated with improvements in the solvency of UI trust funds, as measured by reserve ratios, the percent of total wage in trust fund reserves.⁹⁶

In the almost-century since UI was created, its program and funding mechanisms have not kept pace with the changing face of unemployment and the financial demands upon the system that economic downturns create. Instead, states often have adopted policies that underfund their UI trust funds and lead to fiscal crises. As the Great Recession demonstrates, immediate reforms at both the federal and state level are necessary to provide economic relief to the nation's unemployed and to help both federal and state governments get their fiscal houses in order to ensure both short-term and long-term UI solvency.

Appendix A: Comparison of State Unemployment Insurance Funds

| State | Federal Loan Balance* | Taxable Wage Base** | Average Weekly Benefit Payout*** | Unemployment Rate**** |
|----------------------|-----------------------|---------------------|----------------------------------|-----------------------|
| Alabama | \$6,495,902.64 | \$8,000 | \$204.56 | 9.3 |
| Alaska | \$0.00 | \$34,200 | \$238.61 | 7.4 |
| Arizona | \$329,267,575.81 | \$7,000 | \$209.74 | 9.0 |
| Arkansas | \$330,853,382.53 | \$12,000 | \$279.60 | 8.2 |
| California | \$9,400,080,566.26 | \$7,000 | \$294.76 | 11.7 |
| Colorado | \$293,618,628.37 | \$10,000 | \$341.32 | 8.1 |
| Connecticut | \$809,875,582.98 | \$15,000 | \$325.16 | 8.7 |
| Delaware | \$62,523,367.88 | \$10,500 | \$247.63 | 7.9 |
| District of Columbia | \$0.00 | \$9,000 | \$298.82 | 11.0 |
| Florida | \$1,722,700,000.00 | \$7,000 | \$231.35 | 10.3 |
| Georgia | \$721,080,472.00 | \$8,500 | \$268.37 | 10.2 |
| Hawaii | \$0.00 | \$34,200 | \$409.20 | 6.5 |
| Idaho | \$0.00 | \$33,300 | \$248.24 | 8.8 |
| Illinois | \$1,953,726,990.44 | \$12,740 | \$300.12 | 10.1 |
| Indiana | \$1,908,972,240.20 | \$9,500 | \$293.81 | 9.0 |
| Iowa | \$0.00 | \$24,700 | \$311.57 | 6.0 |
| Kansas | \$39,070,717.40 | \$8,000 | \$316.49 | 6.7 |
| Kentucky | \$948,700,000.00 | \$8,000 | \$286.38 | 9.6 |
| Louisiana | \$0.00 | \$7,700 | \$194.85 | 7.0 |
| Maine | \$0.00 | \$12,000 | \$280.97 | 7.3 |
| Maryland | \$0.00 | \$8,500 | \$325.20 | 7.2 |
| Massachusetts | \$0.00 | \$14,000 | \$389.93 | 7.3 |
| Michigan | \$3,152,239,816.84 | \$9,000 | \$287.58 | 10.6 |
| Minnesota | \$114,631,346.42 | \$27,000 | \$348.59 | 6.4 |
| Mississippi | \$0.00 | \$14,000 | \$190.10 | 10.6 |
| Missouri | \$725,446,730.74 | \$13,000 | \$236.97 | 8.5 |
| Montana | \$0.00 | \$26,300 | \$253.39 | 7.6 |
| Nebraska | \$0.00 | \$9,000 | \$260.24 | 4.2 |
| Nevada | \$725,192,986.08 | \$26,600 | \$303.90 | 13.4 |
| New Hampshire | \$0.00 | \$12,000 | \$287.32 | 5.3 |
| New Jersey | \$1,323,302,821.41 | \$29,600 | \$395.59 | 9.1 |
| New Mexico | \$0.00 | \$21,900 | \$298.99 | 6.6 |
| New York | \$3,176,709,441.00 | \$8,500 | \$301.01 | 7.9 |
| North Carolina | \$2,576,154,814.29 | \$19,700 | \$292.11 | 10.4 |
| North Dakota | \$0.00 | \$25,500 | \$317.33 | 3.5 |
| Ohio | \$2,213,387,131.00 | \$9,000 | \$291.25 | 9.0 |

| | | | | |
|---------------------|---------------------|----------|----------|-------------------------------|
| Oklahoma | \$0.00 | \$18,600 | \$262.97 | 6.1 |
| Oregon | \$0.00 | \$32,300 | \$290.24 | 9.5 |
| Pennsylvania | \$3,123,737,549.04 | \$8,000 | \$336.62 | 8.1 |
| Puerto Rico | \$0.00 | \$7,000 | \$117.22 | 16.1 |
| Rhode Island | \$208,433,938.68 | \$19,000 | \$383.57 | 10.4 |
| South Carolina | \$782,562,815.45 | \$10,000 | \$239.10 | 10.5 |
| South Dakota | \$0.00 | \$11,000 | \$256.01 | 4.5 |
| Tennessee | \$0.00 | \$9,000 | \$238.46 | 9.6 |
| Texas | \$0.00 | \$9,000 | \$314.58 | 8.4 |
| Utah | \$0.00 | \$28,600 | \$311.58 | 7.0 |
| Vermont | \$77,731,860.63 | \$13,000 | \$293.76 | 5.6 |
| U.S. Virgin Islands | \$29,299,690.81 | \$22,600 | \$307.68 | 9.7 ⁺ (as of 9/11) |
| Virginia | \$243,063,000.00 | \$8,000 | \$288.83 | 6.4 |
| Washington | \$0.00 | \$37,300 | \$392.11 | 9.0 |
| West Virginia | \$0.00 | \$12,000 | \$250.88 | 8.2 |
| Wisconsin | \$1,158,016,656.38 | \$13,000 | \$266.67 | 7.7 |
| Wyoming | \$0.00 | \$22,300 | \$328.51 | 5.7 |
| Total | \$38,156,876,025.28 | | | |

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Appendix B: Characteristics of Key Federal UI Legislation

| Name of Legislation | Modernization | Temporary Emergency Compensation | Benefit Qualifications changes | Taxable wage increase | Provisions regarding loans to states | Increase FUTA |
|---|---------------|--|--------------------------------------|--------------------------|--|------------------|
| Social Security Act of 1935 (established UI program) | | | | | | |
| Employment Security Administrative Financing Act of 1954 (known as the Reed Act) | | | | | X | |
| Temporary Unemployment Compensation Act of 1958 | | X | | | X | |
| Social Security Amendments of 1960 | | | | | X | X |
| Temporary Extended Unemployment Compensation Act of 1961 | | X | | | | |
| Employment Security Amendments of 1970 | | X (Makes EB permanent) | | | | X |
| Omnibus Budget Reconciliation Act of 1981 | X | | X | | X | |
| Tax Equity and Fiscal Responsibility Act of 1982 | | X | | X | X | |
| Supplemental Appropriations Act of 2008 | | X | X | | | |
| American Recovery & Reinvestment Act of 2009 | X | X | X | | | |
| Worker, Homeownership, and Business Assistance Act of 2009 | X | X | | | | |

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