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Committee on Finance

Hearing on Unemployment Insurance Benefits
Where Do We Go From Here?

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Chairman Baucus, Ranking Member Grassley, and members of the Committee On Finance, thank you for the opportunity to testify this morning on the topic of "Unemployment Insurance Benefits: Where Do We Go From Here".

I am Douglas J. Holmes, President of UWC- Strategic Services on Unemployment & Workers' Compensation (UWC). UWC counts as members a broad range of large and small businesses, trade associations, service companies from the Unemployment Insurance (UI) industry, third party administrators, unemployment tax professionals, and state workforce agencies. The organization traces its roots back to 1933 at the time when unemployment insurance was first being considered for enactment.

The hearing this morning is very aptly named and timely in addressing the question of where we go as we turn the corner on an economic recession which by most accounts is equal to or larger in scope than the deep recessions of the 1970s and early 1980s.

In exploring where we go from here, we should consider a number of factors, including 1) the trend in unemployment initial claims for state unemployment compensation, 2) the trend in employment, 3) the impact of the current American Recovery and Reinvestment Act (ARRA), 4) the cost of further federal extensions, 5) the impact of alternative options on the creation of sustainable jobs, and 6) the administrative and tax burden on the federal/state unemployment tax system and employers.

Unemployment and Employment Trends

The seasonally adjusted initial unemployment claims numbers are trending down. As the Congressional Budget Office indicated in its August update, the number of initial claims peaked nationally in March and continues to trend down. The most recent report from USDOL released on September 10th, shows that the number of initial claims continued to trend down to 550,000, a 26,000 claim reduction from the previous week. This data is the most important leading indicator in projecting where the economy is headed. As fewer individuals become unemployed, the number of weekly claims will follow with declines.

The loss in employment has slowed in recent months with net growth in employment just around the corner and growth in employment in some sectors already being reflected in reported employment. The employment report from the US Bureau of Labor Statistics for August released on September 4th shows net employment growth in August over July in a number of sectors, most notably Education and Health Services, Retail Trade in Motor Vehicles and Parts, Automobile Dealers, Department Stores and General Merchandise Stores, and Government.

Although the total unemployment rate, which is broadly reported by the media, is high at 9.7%, and will likely remain high for a number of months, it is not the best measure of progress in employment recovery as it includes numbers of individuals new to the job market or who were previously discouraged from participation in the

job market. The fact that discouraged workers are now once again actively seeking work is an indication of improving health in the economy even though their inclusion in the unemployment rate calculation may result in temporarily higher total unemployment rates.

Economists agree that we are turning the corner on the recession and the economy is already growing again or about to show growth, with net growth in employment hopefully to follow.

We must also be mindful; however, that measures taken now to add further UI benefit expansion costs and/or tax increases could jeopardize the recovery and result in a double dip recession.

History provides us with a point of comparison of which we should take note --- the 1970s and early 1980s. The US economy suffered a recession from late 1973 to 1975 due to an oil crises and a stock market crash. The recession prompted considerable federal spending that depleted state and federal unemployment trust funds. Before the system could fully recover, this recession was followed with a short recession from January to July 1980 and then a double dip recession from July 1981 to 1982. The result was significantly higher unemployment claims and tax rates and higher long term unemployment rates until 1989.

Where we should go from here is to take no steps that would increase the risk of a double dip recession and focus efforts on creating jobs and reducing the cost of employment to continue the trend line to lower unemployment claims. A number of legislative steps and policies would be helpful in assuring a sustained recovery.

1. **Minimize Federal and State Unemployment Taxes**

Employers decide to create jobs and maintain higher levels of employment based not only on the demand for goods and services but also on the costs associated with employees. Unemployment insurance has been a relatively low payroll cost in recent years, but it will quickly become much more significant in 2010 and the years following.

The UI program is a social insurance program that is funded by employers through dedicated state and federal payroll taxes. The state tax is experience rated, so that state UI taxes go down during periods of low claims volumes, such as we experienced from 2003 to 2007. State unemployment experience rates for 2010 in most states will be based on claims levels during the period from July 1, 2008 through June 30, 2009, one of the twelve month periods with the largest number of claims on record.

Without further federal legislation, state unemployment taxes are likely to double on average in the next two years and to stay at a much higher rate for a decade before solvency returns to state UI trust funds. Employers with relatively low state unemployment taxes will experience even greater percentage increases as a series of state solvency taxes are imposed to address state unemployment trust fund insolvency.

As a point of comparison, the first year after the end of the 1982-83 recession, state UI taxes were twice as high as a percent of operating costs as they are today.

In response to significant extended unemployment compensation payout in the 1970s, the employer financed federal unemployment accounts dedicated to paying these claims were depleted and federal general revenue was advanced to cover the deficiency in funds. In 1976 the FUTA tax base was increased from $4,200 to $6,000 and the net FUTA tax rate was increased from 0.5% to 0.7%. In 1982, the FUTA tax base was increased from $6,000 to $7,000. The net federal tax rate was increased from 0.7% to 0.8% on a “temporary” basis until general revenue funds that had been advanced to pay extended benefits were repaid. Although all general revenue advances were repaid in 1987, the “temporary” surtax to be paid by employers was continued and is scheduled to sunset at the end of 2009.

These tax increases could have been avoided and more jobs created during this period with careful management of unemployment benefit spending levels on the front end and recognition that payroll tax increases negatively impact employment growth.

The FUTA 0.2% “temporary” surtax should be permitted to sunset after this year to reduce the cost of employment and increase the likelihood that new jobs would be created.

2. Avoid Further Increasing the Federal Debt

The combination of the increase in state unemployment claims due to the recession and additional spending under the ARRA has caused a jump in spending from $43 billion in FY 2008 to $116 billion in 2009 and a projected $109 billion in 2010 and $79 billion in 2011. These increases do not include additional spending that would be part of further ARRA provision extensions or expansions that have recently been introduced.

It is not clear how the existing federal UI account deficits will be addressed in the years to come. The EUC and FUA accounts ran out of funds before the end of FY 2009 requiring a last minute appropriation and adjustment in the debt ceiling. The accounts are now borrowing from general revenue to cover the burgeoning Title XII loan requests from states as well as the increased stimulus spending for extended benefits. Even without a further extension or expansion of the ARRA provisions, the federal unemployment accounts and many state unemployment benefit accounts will be in deficit positions for years to come.

An additional $70 to $74 billion in spending to extend the ARRA UI benefit provisions and provide more weeks of unemployment compensation for individuals in states with total unemployment rates of 8.5% or higher has been proposed in S 1647. If enacted, this legislation would enable unemployed workers in high unemployment states to be paid up to 92 weeks in combined state and federal unemployment compensation with no intervening employment.

3. Rely on the Regular State Unemployment and Federal Extended Benefit System to Provide a Continuing Safety Net as the ARRA Provisions End

The provisions of the ARRA significantly increased the funds available to unemployed individuals since February and have assisted many individuals in making necessary purchases, paying credit card minimum payments, and avoiding greater losses in savings than otherwise would have been the case. The primary ARRA UI benefit provisions in effect today include

a. An Emergency Unemployment Compensation (EUC) program which provides up to 20 weeks of emergency unemployment compensation to individuals in all states who exhaust state unemployment compensation (typically providing up to 26 weeks of benefits); unemployed individuals in states with insured unemployment rates of 4.0% or more or three month average total unemployment rates of 6.0% or more may receive up to an additional 13 weeks on top of the 20 weeks of EUC to total 33 weeks. As of September 13th, all states and jurisdictions except Iowa, North Dakota, South Dakota, Utah and Wyoming were triggered on for the additional 13 weeks of EUC;
b. A Federal Additional Compensation (FAC) program providing individuals claiming state unemployment compensation or federal emergency or extended compensation, with an additional $25 per week of unemployment compensation; unemployed workers in all states are eligible to receive these payments;
c. A special 100% federal reimbursement provision under which states choosing to adopt the optional regular extended benefit trigger based on the total unemployment rate would receive 100% reimbursement to their state unemployment benefit accounts from the federal extended unemployment compensation account instead of the usual 50% reimbursement. As of September 13th, 40 states were triggered on 13 or 20 weeks of regular federal extended benefits and 37 of these states were triggered on based on the optional trigger. States and jurisdictions not triggered on regular federal extended benefits as of September 13th included Hawaii, Iowa, Louisiana, Maryland, Mississippi, Montana, Nebraska, North Dakota, Oklahoma, South Dakota, Utah, Virgin Islands, and Wyoming.

The ARRA UI benefit provisions have had their intended effect in increasing the number of individuals receiving unemployment compensation, increasing the duration of unemployment compensation, and increasing the amount to be paid in weekly unemployment compensation during the recession. The additional spending has responded to immediate cash needs for individuals, but it has also resulted in the total depletion of the federal unemployment account balances, contributed to the insolvency of many state UI trust funds, and increased the duration of unemployment for many unemployed workers. This level of spending is not sustainable.

The EUC program has not only has dramatically increased the amount of unemployment compensation being paid from federal general revenue, but has had the effect of increasing the duration of unemployment compensation paid from state UI trust funds.

Because individuals gauge their work search activities in part based on their perceived need, the availability of additional weeks of federally funded unemployment compensation results in individuals remaining on unemployment compensation for longer periods of time. A rough rule of thumb used by CBO is that making benefits available to all regular UI recipients for an additional 13 weeks increases their average duration of unemployment by about two weeks and that increasing UI benefit levels by 10 percent increases the average duration of unemployment by about one week. By this measure the addition of 20 or 33 weeks of EUC serves to increase the duration of unemployment by as much as 4 or 5 weeks beyond the number of weeks that the individual would otherwise have been unemployed. Of course it should be noted that these are averages and that individuals in labor markets where employment is not available may not be able to find employment despite considerable work search efforts.

The FAC program, by increasing unemployment compensation by $25 per week, similarly results in increased duration of unemployment compensation. Unemployment compensation weekly benefit amount payments are in the $300 average range in many states. A $25 per week addition is nearly a 10 percent increase, and for claimants with lower wages this additional weekly payment is an even more significant disincentive to searching for work. Seven states and jurisdictions, including Delaware, Hawaii, Nevada, Oklahoma, Puerto Rico, South Carolina, and Louisiana, provide for weekly benefit amounts of less than $25 per week. In such states, the additional $25 per week represents a 100% or more increase in benefits for these low wage or part-time workers.

Prior to the special 100% federal reimbursement, most states had not adopted the optional trigger because it triggered on extended benefits earlier than the state viewed as necessary and/or because the state unemployment trust fund was only reimbursed at the 50% rate for benefits paid under the program. It should be noted also, that the regular federal EB program does not provide for reimbursement to state or local government or Indian tribe accounts. As a result, if there is a further extension of this provision increased costs will be imposed on state and local political subdivisions and Indian Tribes.

The result of the ARRA provision is not only to significantly increase the number of states triggering on regular federal extended benefits of 13 or 20 weeks, but significantly increasing the amounts needed from the Federal Extended Unemployment Compensation account to provide for state reimbursement.

The ARRA programs are scheduled to end in December with some continuing features through May of 2010. That should be sufficient time in which to further evaluate the effect of these provisions without enacting legislation that would result in $70 billion more in entitlement spending through May of 2011 and increasing the federal deficit.

The regular Federal/State unemployment insurance system will continue to be in place after the special ARRA provisions end and will continue to provide a partial wage replacement safety net. Individuals who become unemployed through no fault of their own will typically be paid up to 26 weeks of state unemployment compensation benefits and individuals in states with higher unemployment rates will be eligible for up to 13 or 20 weeks of federal extended benefits.

4. **Distribute the remainder of the $7 billion of "UI Modernization" funding to states as Reed Act distributions without requiring states to enact expanded benefit provisions as conditions of distribution**

Many state UI Trust Funds across the country are in deficit positions or likely to run out of funds to pay benefits in the next year. Each state's share of the $7 billion in "UI Modernization" funds could very easily be transferred into each state unemployment benefit account.

As of September 8th, 19 states had outstanding Title XII loan balances totaling over $14.6 billion yet only 7 of these states had received full UI Modernization incentive payments and only 3 had received one-third of the payments. Clearly, many states have determined that the long term costs of the "UI Modernization" provisions exceed the benefit of small one-time incentive payments. This determination should not preclude them from receiving these funds.

Under the normal Reed Act provisions these funds would immediately improve state UI trust fund solvency and could be used by each state as necessary to properly administer unemployment insurance and employment security functions.

5. **Focus efforts on UI system integrity, job search, reemployment services, and targeted training**

UI System Integrity

During the recession it has been understandably difficult for state UI administrative staff to focus on benefit payment control, fraud and overpayments when the priority has been to assure that the growing number of unemployed workers were able to complete their applications, weekly claims forms and be paid quickly.

During times when significant numbers of claims are processed under strained conditions the likelihood is that the number paid erroneously and the incidence of fraud increases. Even in non-recession years, approximately 10% of unemployed claimants are erroneously paid benefits for a variety of reasons and in most cases the erroneous payments are overpayments. Fraud, which typically ranges from 2% to 3% of payments also increases with the amount of payments being made. A UI program that pays out more than $100 billion is likely to have overpayments of close to $10 billion and increased fraud up to $3 billion in fraudulent payments. In light of this, targeted administrative funding is needed for state UI agencies to procure detection and collection systems and staffing to increase the integrity of the system.

UWC supports the cross-matching of quarterly wage information, and new hire data bases with unemployment claims data to identify overpayments and fraud. Federal legislation requiring a monthly statement of charges to employer accounts would be helpful in indentifying erroneously paid and charged benefits. Investment in detection and recovery has been shown in a number of states to increase recoveries and enable more effective fraud prosecution.

UWC members are currently working with the US Department of Labor and a number of state employment security agencies to develop and implement encrypted web based systems to improve the speed, efficiency and effectiveness in obtaining information needed to determine claims eligibility.

Job Search and Reemployment Services

It has been well established that effective job search reduces the number of weeks that individuals remain on unemployment compensation and serves to more quickly fill the staffing needs of employers. The use of web based job search systems and public/private partnerships has demonstrated that greater efficiency and effectiveness in job search can be a win/win by reducing the duration of unemployment compensation, and returning unemployed workers to the workforce more quickly.

Employer based programs, such as customized training, on the job training, and programs such as Georgia Works that permit individuals to work as employees or trainees in anticipation of long-term employment can also be effective.

Targeted Training

Individuals qualifying for unemployment compensation benefits typically have work experience and training from prior work that enables them to find similar work. However, particularly during a long term recession such as we have experienced, a larger number of individuals become structurally unemployed and may find themselves with skills that are no longer in demand in the labor market.

These individuals may require services well beyond the temporary partial wage replacement provided by the UI program and job search services. These long-term unemployed individuals are best served through private and public programs such as Trade Adjustment Assistance and the Workforce Investment Act that provide a broader array of support services, assessment, testing, skills training, and referral services.

Geographic Relocation

Recessions of the size we have just experienced typically result in significant geographic shifts in the availability of employment as the market adjusts to the emerging areas of growth and employment levels do not return in certain labor markets.

Individuals remaining unemployed for extended periods, certainly those remaining unemployed for 79 weeks, should be encouraged to consider relocating to other geographic locations and relocation assistance can remove barriers to individuals seeking employment.

Individuals who are long-term unemployed should expand their work search to states and regions other than the labor market in which they currently reside. States with the lowest total unemployment rates may actually have labor shortages and employers in these states may be recruiting. The thirteen states with the lowest unemployment rates include Montana, Iowa, North Dakota, Utah, Wyoming, South Dakota, Oklahoma, Nebraska, Virginia, New Mexico Louisiana, Hawaii, and Maryland.

Conclusion

The change in the shape of the economy since February, when the ARRA was passed, calls for a new approach to UI benefits. As we turn the corner on recovery we should move swiftly from efforts to expand the UI system to provide the maximum amount of unemployment benefits to one that creates jobs and assists unemployed workers in finding jobs.

The regular federal/state unemployment system remains in place to provide partial wage replacement compensation of up to 26 weeks under state UI law and up to 13 or 20 weeks of federal extended benefits for individuals in states with high unemployment rates.

We should follow the initial claims and employment trends closely through the balance of the year, avoid adding new federal debt, and reduce federal UI payroll taxes in recognition that state UI taxes will be increasing significantly in the next three years.

State shares of the $7 billion reserved for “UI Modernization” should be distributed to the states as Reed Act distributions without requirements that state UI benefit entitlement be expanded.

Strategic administrative funding to address fraud and integrity of the UI system is needed as well as funding for measures to reduce the duration of unemployment compensation and return unemployed workers to work.