National Employment Law Project

State of Vermont
Senate Committee on Finance

Testimony regarding S. 290
"An Act Relating to Restoring the Solvency of the Unemployment Trust Fund

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Testimony of National Employment Law Project
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Introduction

Good afternoon. My name is George Wentworth and I am the Unemployment Insurance Modernization Coordinator for the National Employment Law Project (NELP). NELP is a national law and policy center based in New York City that engages in research, policy analysis and advocacy on behalf of low wage and jobless workers. NELP is committed to improving the effectiveness of the unemployment insurance (UI) system by promoting state and federal policies that will maximize program access for low-wage workers and improve income security for all workers. I want to express my appreciation to the Committee for allowing me to deliver by telephone this testimony regarding Senate Bill 290, *"An Act Relating to Restoring Solvency to the Unemployment Trust Fund."* .

Background

In September, my NELP colleague Rick McHugh provided extensive testimony regarding Vermont's Unemployment Insurance program to the State Unemployment Trust Fund Study Group. At that time, he detailed how the unemployment insurance (UI) program benefits all Vermont residents by:

- Replacing income for laid off workers to prevent hardships and maintain living standards during periods between jobs
- Boosting the economy by maintaining consumer spending and reducing the spread of layoffs through benefit payments from trust funds accumulated during better times
- Providing support for job search and matching of laid off workers to jobs that fit their skills, training, and past work

- Retaining attachment to the labor market and specific employers during temporary layoffs.[1]

Vermont's unemployment insurance program is a good one but is by no means overly generous. The average weekly benefit amount in Vermont is $304, which ranks 25th in the country. The maximum weekly benefit amount is $425 which ranks 17th nationally. Unemployment benefits in Vermont replace – on average – about 41% of unemployed workers' pre-layoff wages.

My testimony this afternoon addresses three major areas. First, I want to provide some perspective on the national trust fund solvency crisis and NELP's view on how states should address this problem. Next, I will speak in general support of the financing reform being proposed in S. 290 and finally, I will detail NELP's opposition to two of the most harmful benefit cuts being proposed in this bill.

Trust Fund Insolvency

Recently, the Vermont Unemployment Trust Fund became insolvent. Vermont is hardly alone in facing insolvency. There is currently a national crisis in the states' UI trust funds. In the past year, the number of insolvent states has grown to 32, including such large programs as California, Michigan, New York, Ohio and Pennsylvania. All New England state trust funds, with the exception of Maine, are currently borrowing. The U.S. Department of Labor (USDOL) has projected that as many as 40 state trust funds may go broke and be forced to borrow from the Federal Unemployment Account by the end of CY2010. To date, states have borrowed approximately $35 billion and USDOL projects that this number may eventually grow to $90 billion.

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[1] See *Advisory Council on Unemployment Compensation, Defining Federal and State Roles in Unemployment Insurance* (1996) p.7

How did states get in this situation? Certain answers are readily apparent. The increase in unemployment rates has been dramatic across the country. The national unemployment rate doubled in less than 2 years and currently stands at 9.7%- up almost 5 points from where it was when the recession began in early 2008. The depth of the recession is clearly another key factor. Today, 41% of all unemployed workers are considered long-term unemployed – unemployed for 26 weeks or longer - the highest percentage since records have been kept. In nearly every state, workers are relying on unemployment insurance for longer durations than in any prior economic downturn.

But there is another part to the story. In general, most state unemployment trust funds did not do enough to prepare for this recession and, in fact, were less prepared than they were for the last recession. At the beginning of CY2001, there was about $54 billion in state trust funds to withstand the national recession that followed 9/11. By way of comparison, state trust fund balances had dropped to about $38 billion by the beginning of CY2008 when the current recession began- a decline of over 42%. While the breadth and depth of this recession have accelerated the current trust fund crisis, the problem – now national in scope - has its roots in the failure of many states to engage in responsible financial planning.

Unemployment Insurance financing experts are generally agreed that there are three key features in maintaining healthy unemployment trust funds: (1) adherence to forward funding principles, (2) setting taxable wage bases that are responsive to recessionary payment levels, and (3) indexing taxable wage bases as a percentage of the state's average annual wage.

To meet the primary goals of the UI program - payment of adequate temporary wage replacement to involuntarily unemployed individuals and stimulation of economic activity by maintaining consumer spending - a state must have a UI financing mechanism that will collect sufficient UI payroll taxes to maintain a strong program. UI programs were intended by their designers to accumulate reserves in trust funds prior to recessions in order to provide funding of higher UI claims during economic downturns. This is known as "forward financing."

Wayne Vroman, the nation's leading authority on UI financing, summarizes the economic rationale supporting forward funding of UI programs:

> Trust fund balances are built up before recessions, drawn on during recessions, and then rebuilt during the subsequent recoveries. The funding arrangement implies that the program acts as an automatic stabilizer of economic activity, that it makes larger benefit payments than tax withdrawals during recessions and larger tax withdrawals than benefit payments during economic expansions.

Under the same rationale, cutting UI benefits or raising UI payroll taxes during a recession undermines the positive economic impact of UI. We support forward financing because state UI programs work best when they build up trust fund reserves during periods of economic growth and then rely upon those reserves to moderate or avoid UI payroll tax increases and/or UI benefit restrictions during economic recessions.

Indexing is usually accomplished by setting a state's taxable wage base as a percentage of a state's average annual wage in a prior 12 month period. Of the 15 states with indexing, the

formula ranges from 100 percent in Idaho to 50 percent in North Carolina, with a couple of states using less common methods. (See chart below.) Indexing promotes UI solvency because weekly benefit amounts increase each year due to growth in wages. As a result, average benefit payouts rise without any legislative action, even when a state freezes the maximum weekly benefit amount. In general, indexing taxable wage bases has proven over the course of this recession to be the most reliable method of maintaining solvency. Ten of the 15 states that index their taxable wage bases have maintained solvency in their trust funds during this recession

States with Indexed Taxable Wage Bases

Taxable Wage Base	State	Indexing Criterion
$31,300	Alaska	75% SAAW
$32,200	Idaho	100% SAAW
$22,800	Iowa	66.7% AWW times 52
$25,000	Minnesota	60% SAAW
$23,800	Montana	80% SAAW
$23,800	Nevada	66.7% SAAW
$27,700	New Jersey	28 times AWW
$19,900	New Mexico	65% SAAW
$18,600	North Carolina	50% SAAW
$22,100	North Dakota	70% SAAW
$13,600	Oklahoma	50% SAAW
$30,200	Oregon	80% SAAW
$26,700	Utah	75% prior fiscal year wage
$21,800	Virgin Islands	60% SAAW
$34,000	Washington	115% of prior TWB but not more than 80% SAAW
$20,100	Wyoming	55% SAAW

Note: SAAW is state annual average wage. AWW is state's average weekly wage.
Source: USDOL Comparison of State Unemployment Insurance Laws (July 2008), Table 2.2.

Vermont had a taxable wage base of $8000 from 1983 until last year when the Legislature raised it to $10,000. In 1983, Vermont's average weekly UI benefit was $110, and the ratio of taxable wages to average weekly wages was 0.514. In other words, the portion of wages subject to UI taxation was roughly 50 percent. By 2008, average weekly UI benefits had risen to $294 while the ratio of total wages to taxable wages had fallen to roughly 25 percent. In short, wages had risen and resulted in higher weekly benefits, but Vermont was still financing those benefits on the same first $8000 of annual wages for each taxable employee.

It is true that high UI taxes can have a negative impact in a slowly recovering economy, but that impact in Vermont should be assessed realistically .The U.S. Department of Labor reports that 66 percent of Vermont employers paid UI payroll taxes equal to or less than 0.5 percent of total wages in 2008. In addition, 63 percent of Vermont employers paid the statutory minimum tax rate of 0.8 percent of taxable wages ($64 per employee on a taxable wage base of $8000) in 2008. The average tax rate for Vermont employers last year was $278 per worker, roughly the national average.

So, while state UI payroll taxes are a component of overall payroll taxes, it is difficult to argue that state UI taxes—which amounted to 0.89 percent of total wages in Vermont in 2009—are a significant factor in determining the vitality of Vermont's economy. Most businesses are not going to move or relocate based upon a UI tax this size. Instead, when compared to wages, health insurance premiums or other payroll taxes, UI taxes are at most a small component of overall labor costs in Vermont.

Nobody likes to raise taxes, but because Vermont's system has been under-funded for so long and because this will likely be a slow recovery, the responsible thing to do is to commit to a long-range plan of forward financing. Because the ranks of UI claimants will likely remain high for the immediate future, it is essential to Vermont's economy that the UI program continues to work as an economic stimulant and that it is adequately financed. Without a commitment to rebuilding the UI trust fund on some sort of reasonable time frame, the political will to maintain a program that

provides meaningful economic support to unemployed workers will be undermined in the coming years. And Vermont's economy will pay an even higher price in terms of increased employer costs associated with federal debt and a system that is unprepared for the next economic downturn..

Section 4 - Proposed Increase in the Taxable Wage Base

NELP supports the proposal in section 4 of S.290 which enacts a long overdue increase in Vermont's taxable wage base to $12,000 next year, $15,000 in CY2012 and $16,000 in CY 2013. For at least 15 years, Vermont's taxes have remained lower than required to adequately finance its unemployment insurance program and increasing the taxable wage base is the most effective and equitable method of restoring financial stability to the trust fund. We would, however, encourage lawmakers in the coming years to consider all the economic research that concludes that for a trust fund to be financially strong over the long term, it is critical to tie the amount of wages being taxed in some way to the state's annual average wage. To maintain a program that will continue to provide a meaningful safety net for Vermont workers and economic stimulus to Vermont communities, the wages that are being insured should be indexed to the growth in wages being paid.

Section 5 – Proposed Change in Formula to Calculate UI Weekly Benefit Amount

The proposed change in the statutory formula for calculating a claimant's UI weekly benefit amount in section 5 of this bill is an unnecessarily harsh measure that will hurt many of Vermont's unemployed workers. The proposal would change the current law in the following way. Today, when a person loses a job and files for benefits, his or her benefit amount is calculated by

looking at a 4-quarter base period of wages. The existing law calls for adding the wages in the two highest quarters of earnings and dividing by 45, This amount is generally calibrated to result in about 57.5% of worker's pre-layoff average weekly wage. Section 5 of this bill would change this formula by averaging the earnings in all four quarters of the base period and dividing by 23.

The result of this change is that the average wage being divided to determine the amount of UI an unemployed worker will receive would now factor in the two lowest quarters for all workers. The stated legislative purpose for this change is to "create an incentive for temporary and seasonal workers to return to work". This proposal is not only wrong-headed as a matter of public policy but overly broad in the manner in which it seeks to remedy the "problem" it purports to remedy. Let me address the primary problems with this proposal.

First, the suggestion that temporary workers need an incentive to return to work is inconsistent with any realistic perspective on the current economy. There are currently more than 5 unemployed workers for every reported job vacancy in this country. The temporary industry is often the best available opportunity for jobless workers trying to find their way back into secure full-time employment. The fact that the gaps in employment that are common for temporary workers should be counted against them twice is completely contrary to the remedial purpose of the program. Workers with periodic unemployment in their recent work histories already have lower benefit rates based on the reduction in their total wages. This proposal would impose a double penalty since the worker's already low total wages would be averaged out in a way that places greater significance on the quarters in which the worker's wages were the lowest, including quarters where there were no wages at all.

Second, despite the stated legislative purpose, this formula hurts many more unemployed workers than those in the seasonal and temporary industries. With the exception of workers with high wages that qualify for the $425 maximum rate, every worker who has had a period of unemployment in his or her base period is potentially affected by this proposal. The bottom line is that Vermont has, to date, relied on the mainstream approach of averaging the claimant's two highest quarters of base period earnings. By taking into account the other two quarters, weekly benefit amounts will decrease for claimants who have been out of work for any reason – whether because of unemployment, unpaid family or medical leave or gaps between assignments. See the following example.

Example

Claimant has base period earnings of $33,000. Wages are spread out over 4 quarters as follows:

Q1	Q2	Q3	Q4
5000	8000	10000	10000

Under current law, the 2 high quarters of $10,000 each are added and divided by 45. Since $20,000 divided by 45 = $444 and that exceeds the statutory maximum of $425, the claimant is entitled to $425 per week.

Under the proposed law change, the claimant's total base period wages ($33,000) are divided by 4 for an average quarterly base period wage of $8,250. This figure is then divided by 23 for a weekly benefit amount of $359.
Thus, the claimant whose $33,000 in wages once qualified her for the maximum benefit of $425 sees a cut of $ 66 per week based on the same exact wages

Only four states – Arkansas, Kentucky, Louisiana and West Virginia – use a 4-quarter average formula to calculate benefits, Vermont's average weekly benefit is $304 – 25th in the country. Does Vermont want to fall further behind in providing meaningful income replacement for those who are unemployed through no fault of their own.

Third, because this proposed change in the formula would reduce the average weekly benefit amount for Vermont claimants, it would be inconsistent with terms of the current agreement between USDOL and the State of Vermont under the Federal Additional Compensation (FAC) program. That agreement, which was authorized in February 2009 by the American Recovery & Reinvestment Act (ARRA), provides an additional $25 in federally-funded benefits to every unemployment check issued to state residents, including regular state UI benefits, extension benefits and Trade Readjustment Allowances (TRA). Under the agreement, any modification in state law during the term of the agreement that would reduce the average weekly benefit amount below the 2008 average would immediately terminate entitlement to the $25 add-on for all Vermont claimants. Congress is in the process of reauthorizing the FAC program (and thereby extending the Vermont agreement) through the end of the year. This is one year longer than the ARRA originally authorized the FAC program. The sponsors of S. 290 have drafted the new benefit reduction formula to take effect at the beginning of 2011, immediately after the likely new expiration date. But, the fact is that we do not know when the FAC program will end. And if Congress decides to reauthorize the program beyond December, the damage caused by this proposal would be further compounded by taking an additional $25 –federally funded dollars – each week out of the pockets of every unemployed Vermont citizen who is receiving any form of UI benefit.

Finally, treating seasonal employees less favorably than all other workers is questionable as a matter of economic policy. Like every other state, Vermont relies on a number of industries that are seasonal in nature to sustain its economy. Slashing the safety net for construction workers and others for whom available work weeks are curtailed by weather only undermines the ability

of Vermont citizens to make a living in these industries, which in turn, threatens the viability of the employers in these industries. But for those who are interested in changing the way Vermont law handles the issue of seasonal employment, I would suggest that there are more effective solutions that do not have the unintended consequences of reducing benefits for large numbers of non-seasonal workers. Whether reexamining tax tables to insure that seasonal employers are paying their fair share in trust fund contributions or establishing a different benefit rate structure tied to the claimant's classification as a seasonal worker, at least 16 other states have crafted statutes that do not harm non-seasonal workers.

Section 7 – Waiting Week

NELP opposes the adoption of the "waiting week" provision in section 7 of S. 290. The "waiting week" is a period at the start of an unemployment claim during which the individual satisfies all requirements for eligibility but for which no benefits are paid. The effect of a waiting week is to deny a week of benefits to a jobless worker. Only if unemployed workers draw their 26th and final week of state benefits as a result of not finding work are they effectively paid for their first week of unemployment. The majority of UI benefit recipients, however, find work prior to exhausting their benefits,

Waiting weeks have outlived their intended purposes. Waiting weeks were originally adopted primarily because states required a delay at the start of a new claim during which agencies processed UI claims manually. There is no continued vitality to this rationale. Like all states, Vermont has wage information available electronically and it is administratively feasible to timely pay UI benefits for the first week of unemployment.

But this proposal is about saving the trust fund dollars. Proponents of waiting weeks argue that the newly unemployed are best equipped to handle a week without pay. But is that a policy Vermont wants to embrace? At a time when over 40% of UI claimants are unemployed for six months or longer, does it make sense to start every worker's bout of unemployment by de-stabilizing the

worker's family finances? While a waiting week may generate substantial savings to a UI trust fund, jobless workers get no waiting week on their rent payments, mortgages or utility bills. Vermont workers forced to rely on unemployment insurance are already losing more than half of their pre-layoff wages. Asking these workers to absorb more of the costs of the UI system is unfair. The purpose of UI is to provide prompt replacement of lost wages, not to drive jobless workers deeper into debt.

The insolvency of Vermont's trust fund is not the result of workers exploiting an overly generous system. Insolvency is the result of a prolonged recessionary economy and years of under-funding the UI system. The imposition of a waiting week – like the 4-quarter averaging formula – is a gross overreaction to the current situation that will needlessly hurt the vast majority of unemployed workers. For some, cutting benefits to those unemployed who are trying to survive the worst labor market in years may seem like a necessary equality of sacrifice. But these cuts are not necessary to make Vermont's trust fund solvent. They are merely further punishing the victims of a tough economy.

Thank you for your attention and the opportunity to address the Committee.

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