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Scott Gibbons
Chief Evaluation Office, OASP,
U.S. Department of Labor, Room S-2312
200 Constitution Avenue NW
Washington, DC 20210

Submitted Via Email to: ChiefEvaluationOffice@dol.gov

**Re: USDOL Agency Information Collection Activities
OMB Control No. 1290-oNEW**

Dear Mr. Gibbons:

We write in response to a Federal Register notice published December 11, 2017 (vol. 82, pp. 58219-58220) seeking comments regarding approval of an information request by the U.S. Department of Labor (Labor). Labor is conducting a study of non-traditional methods of financing state unemployment insurance (UI) trust fund loans and seeks to conduct structured interviews with individuals who are involved with state UI financing activities as part of this study.

These comments are submitted on behalf of National Employment Law Project (NELP), a nonprofit research and advocacy organization. NELP frequently studies UI issues and advocates policies which will strengthen the protections offered to jobless workers by UI. (Earlier documents prepared by NELP are relied upon without citation in these comments.)

The scope of UI programs and related borrowing is not widely understood. Over the course of the Great Recession and the recovery (2008 to 2017) 36 states borrowed federal loans amounting to \$162.3 billion. Less than \$4 billion of these federal loans remain outstanding. States issued bonds or took out loans of \$11.4 billion in private debt to rebuild trust fund balances, and roughly \$7 billion of that private debt remained unpaid as of March 2017.

Due to the virtual absence of reporting requirements by states to Labor about private bond issuances for state UI trust fund financing, there is virtually no available public information regarding the comparative costs of federal loans and private bonds, the pitfalls or advantages of each of these approaches, and implications of non-traditional private loans on UI financing. The overall USDOL research project as well as the information request that is the subject of this request for comments will provide information for federal and state policy makers, researchers, and other stakeholders about the advantages and disadvantages of private bonding in UI financing. Currently, there is little public information about the details of private bonding's implications and state agencies are forced to make financing decisions largely based upon information furnished by parties who stand to financially benefit from the issuance of private bonds. For this reason, NELP supports not only the information that Labor proposes to collect from individuals, but submits that a broader research effort is

justified by having public officials at both the federal state levels armed with greater information than is currently available.

NELP further outlines the reasons it supports the information request in the remainder of these comments.

1. Traditional State UI Financing Methods

The twin goals of unemployment insurance are payment of adequate temporary wage replacement to involuntarily unemployed individuals and stimulation of economic activity by maintaining consumer spending. For many decades following the creation of UI in the late 1930s, most states followed a philosophy of building up trust fund reserves during economic recoveries and using those reserves to pay the increased levels of benefits that are required during economic recessions. This traditional approach to UI financing is often called forward funding. Obviously, having state reserves that are used for paying adequate benefit levels to a reasonable proportion of jobless workers translates to making state UI programs more effective countercyclical mechanisms. For this reason, forward funding is consistent with the federal programmatic goals of UI.

Forward funding has policy and economic advantages. First, there is less pressure to cut benefit levels or impose eligibility restrictions during a recession. Second, UI payroll tax increases during a downturn can be delayed or mitigated if a state has sufficient reserves. Since employers are better positioned to pay UI payroll taxes during periods of economic recovery than during recessions, forward funding of UI increases the proportion of UI payroll taxes paid when employer payrolls and profits are increasing. In contrast, issuing bonds due to trust fund insolvency imposes fees and dedicated taxes during or soon after a recession when employers are less able to pay higher payroll tax costs.

Even if state trust fund reserves are not fully capable of absorbing the full impact of a severe recession, as with the 2009-2010 Great Recession, those states with higher reserves can better protect their economies and jobless workers without resorting to a combination of tax increases and/or benefit reductions during recessions. In a 2012 briefing paper, NELP replicated the impact of the Great Recession on state UI trust funds to that point. NELP found that if states had started the Great Recession with an average high cost multiple (AHCM) of 1.0 (representing trust fund reserves of one year of average recession-level benefit payments) many fewer states would have borrowed significantly less money in federal and private loans ([Evangelist 2012](#)).

Historically, the federal government has served as a backstop for the state trust funds, making federal loans to states automatically to avoid exhausting trust fund reserves. States are able to borrow as much as they need to cover UI claims; however, long-term loans accrue federal interest and states that fail to pay back loans after two years are subject to automatic federal repayment mechanisms. To avoid the opprobrium associated with taking federal loans for UI trust funds and to potentially avoid some of the costs associated with federal Title XII borrowing, a growing number of states have turned to private bonds over the past two recessions. This development is a worthwhile focus for further investigation.

2. Erosion of Forward Funding of State UI Programs

Forward funding of UI trust funds requires longer-term perspectives than most federal and state stakeholders take; a willingness to raise taxes on employers when there is no existing crisis; and defending trust fund reserves, rather than cutting state UI taxes. An accurate description of the last three decades is that UI solvency has not been taken seriously at the federal level and in the majority of states. While a handful of

states and their employers have made UI solvency a priority, in a majority of states, stakeholder approaches to trust fund solvency have ranged from studied indifference to explicit abandonment of forward financing as a legitimate policy goal (Evangelist 2012).

One main indicator of this erosion in state solvency is the decline of state UI payroll taxes paid by employers. In the 1990s, state UI taxes were at a historically low 0.76 percent of total wages, falling to only 0.65 percent of total wages for the 2000s decade. Despite the Great Recession, UI payroll taxes have averaged only 0.78 percent of total wages for the eight years of the current decade (2017 rates are estimates by USDOL). The federal partner needs legal authority from Congress to require states to build UI reserves, otherwise the overall decline in state UI trust fund solvency will likely continue.

Under recent USDOL regulations, states that do not have an AHCM of 1.0 for at least 1 of the 5 most recent years, will no longer get interest free “cash flow” loans when they initially use federal trust fund advances. See 20 C.F.R. § 606.32(1)(iii). This regulation creates a target for advance financing that will likely influence some states to pay greater attention to trust fund solvency, but it falls short of legally requiring states to take prudent steps to forward fund UI trust funds. In its 2017 Solvency Report, USDOL found that 21 states had reached its interim target for interest-free cash flow loans in 2018. The full 1.0 AHCM target will take effect in 2019. While the limits in cash flow loans may reduce the temptation of states to delay state-level measures toward greater solvency, they are not a big enough financial incentive for many states to overcome their resistance to raising taxes on employers or build bigger trust fund reserves in our experience.

3. Observations about Private Bonding for UI Financing

NELP has advised stakeholders concerning UI financing throughout the last two decades, including advising on the potential merits of private bonding. NELP first issued a publication on the use of bonds in 2004, and was deeply involved with states discussing UI tax and benefit changes in indebted states during and following the Great Recession. See Rick McHugh, [Bond Financing For Insolvent State Unemployment Insurance Trust Funds](#) (2004).

In this report, NELP drew five main conclusions, three of which are most relevant here. In our view, any complete study of the role of private bond financing for UI when compared to federal loans should consider these three points.

- State flexibility under federal borrowing is a considerable advantage that can get lost in a simple cost comparison between interest rates for private borrowing and federal loans. Significantly, federal loans bear interest only on their average daily balance, not the total amount of loans borrowed. And, interest-free federal “cash flow” loans are available to states meeting Labor’s AHCM standards until September 30 each year. Making use of these features, states can reduce the costs of Title XII borrowing.
- The collection of cost information from states would permit greater transparency on past transactions and permit future cost comparisons. The costs of private bonds include underwriting, insurance, legal and servicing costs that are not present in federal loans and not typically disclosed. These fees differ based upon the maturities of the underlying bonds and whether or not the bonds are for a fixed term or callable bonds. In general, the longer a bond’s maturity the more expensive the interest, and callable bonds normally have higher interest premiums as well.
- Insolvent states’ best strategy probably includes a combination of maintaining the lowest possible average daily federal loan balance while employing federal cash flow borrowing prior to September 30. During the last calendar quarter, states can use short-term debt instruments to obtain sufficient

funds to avoid interest-bearing federal loans, repaying the short-term debt with higher UI revenues in the next year or consolidating these short-term debts with other loans. Currently, state UI agency and other state-level stakeholders do not have a sufficient understanding of these options. For this reason, the federal partner should make sure that accurate public information about state options is available.

In our experience, state UI and workforce agencies facing borrowing lack sufficient knowledge to ask the questions required to fully address these and related questions about private bond financing. For this reason, bonding may not be as cost effective as less sophisticated observers might think. Furthermore, federal agency staff can greatly benefit from the collection of experiences from participants in prior states that have used private bonding as well as states that decided against using private bonds. Since the information request here will enable the collection of observations from participants in these past decisions, we support the collection of this information as proposed by USDOL. In addition, we would support the collection of broader categories of information that would enable a broader investigation of these topics.

4. The Context Underlying Use of Private Bonds in UI Financing

Private bond financing for UI has grown in usage over recent decades after beginning in the late 1980s. One factor is undoubtedly related to growth in financial services firms as well as the growth in financial products marketed to governments by those firms. However, in our experience, another major factor in terms of states' interest is the political context surrounding taxation and federal loans. Simply put, many state officials, business group representatives, and state legislators cannot accept enactment of new or higher UI payroll taxes, or even tolerate federal loans no matter how the evident need for them. But, these same stakeholders can accept the issuance fees and interest costs related to private bonds because these carry a label other than "tax increase" or "federal loan." So, voting for a bond is perceived as more acceptable to some state legislators than voting to raise UI payroll taxes, even though the underlying reality is roughly equivalent. Indeed, even if the costs of bonds is more than the costs of properly managed federal loans, some public officials and business group representatives are willing to opt for private bond financing to avoid voting for higher taxes on employers. Or, in some cases, voting to use bond funding without fully exploring its costs in comparison to properly-managed federal loans.

Two recent examples illustrate our bigger political points about private bond financing. In Michigan, two 2011 legislative "solvency" packages made significant cuts in UI benefits. Nearly all the changes were restrictions upon UI benefits. In conjunction with these packages, private bonds were issued in 2012 to repay Michigan's federal UI loan. The details of the bonds were legislatively delegated to unelected state administrators. These administrators made all the significant decisions about the bond issuance, including the amount of bond fee that would be imposed upon employers to raise the funds to repay the bonds. This left the legislators without public responsibility for the UI financing solution, as legislators didn't even have to vote on the amount of the bonding fee. Once the bonds were issued and the federal debt was wiped out, there has been no mention of UI debt in the media. There is very limited public recognition of the significant costs still being paid by Michigan employers to repay the private bonds in 2018. Meanwhile, the main business group in Michigan has celebrated the 2011 two solvency packages as a balanced solution to Michigan's UI financing problems. Interestingly, while Michigan's UI trust fund balance is now sufficient to repay its remaining private debt, the state has not used these trust fund dollars to pay off Michigan's remaining bonds.

Ohio has long neglected its UI financing responsibilities, reflecting the reluctance to deal directly with the difficult choices facing public officials and stakeholders. A partial financial solution proposed by an agency

advisory group failed to pass the legislature in 2006, and the UI financing issue was then largely ignored by stakeholders and public officials until late 2014. At that point, a state legislative study committee was convened. A first legislative effort largely involved benefit cuts as a way to control UI costs. Modestly higher employer taxes in the bill prevented the bill from moving forward in an anti-tax legislature. Instead of dealing with longer-term solvency, the 2016 legislature went for a temporary solution that involved a bill freezing maximum benefits and raising the taxable wage base by \$500. To pay off the remaining \$200 million federal loans, Ohio took a loan from a state fund for unclaimed payments and assessed a one-year assessment on employers. More troubling from a moral hazard perspective, Ohio repaid \$257 million in federal interest from general revenue dollars, rather than making employers foot the bill.

In 2017, a somewhat more balanced Ohio bill that included a cut in maximum weeks of available benefits and a 10-year freeze of annual adjustments of maximum weekly benefit levels was coupled with increases in employer taxes and a new employee contribution. This bill is not projected to get Ohio's UI trust fund to solvency even without assuming that a recession will happen in the next 10 years. This illustrates again the difficulties of states adopting responsible UI financing measures. At the same time, a separate bill was proposed to use private bonds to finance any UI borrowing in Ohio. This separate bill symbolizes the greater acceptance of private bonds over Title XII federal loans apart from any serious comparison of the advantages and disadvantages of these approaches.

In conclusion, the National Employment Law Project (NELP) supports Labor's information request published in the above federal register notice as well as the importance of Labor's underlying study of study of non-traditional methods of financing state unemployment insurance (UI) trust fund loans. In addition, NELP supports greater information transparency regarding the advantages and disadvantages of both traditional Title XII federal loans and private market bonds in financing state UI trust funds.

Sincerely yours,

/s/ Rick McHugh

Rick McHugh
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National Employment Law Project