

Increases in Eligibility, Benefits Lead to Deficits in Employer-Paid State Unemployment Insurance Fund

Background

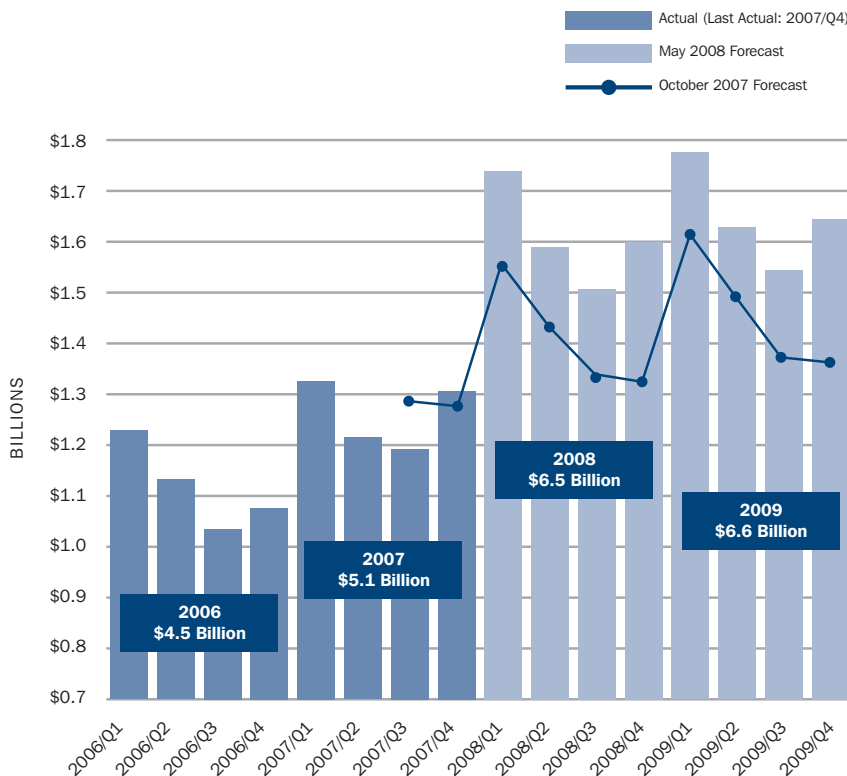
California's unemployment insurance (UI) program is a federal-state program that was created as part of the Social Security Act in 1935. The state of California administers a separate UI program within the guidelines established under federal law. The program provides weekly UI payments for workers who lose their jobs through no fault of their own and meet other eligibility requirements imposed by the state of California. UI benefits act as a stabilizer during economic downturns by being the primary source of temporary, partial wage replacement for workers who have been laid off and are seeking re-entry into the workforce.

California's unemployment rate increased steadily throughout 2008. In August 2008, there was a 61,000-person increase in the number of unemployed Californians. The August increase was the state's fourth increase of 60,000 or more in 2008, but just the fifth since 1976. This latest increase in the number of unemployed Californians occurs when California's economy is slumping and the business climate in California is ranked the sixth worst in the nation by the Milken Institute. This increase in the ranks of the unemployed, coupled with benefit increases over the past several years, has led to a dramatic increase in expenditures from the UI Fund.

California employers pay taxes on the first \$7,000 in wages paid to each employee. The tax rate that employers pay varies based in part on the amount of benefits that have been paid to former employees. In theory, employers who have fewer claims are rewarded with a lower tax rate. Because the UI Trust Fund is currently facing financial difficulties, all employers in California are paying the highest rate allowable under state law, plus a 15 percent solvency surcharge. A portion of the employer's tax goes directly to the federal government to pay for the administration of the fund; the larger portion goes into a special UI Trust Fund used to make benefit payments to unemployed workers. California employers have paid nearly \$20 billion in UI taxes since 2006, with \$4.9 billion paid in 2008 alone.

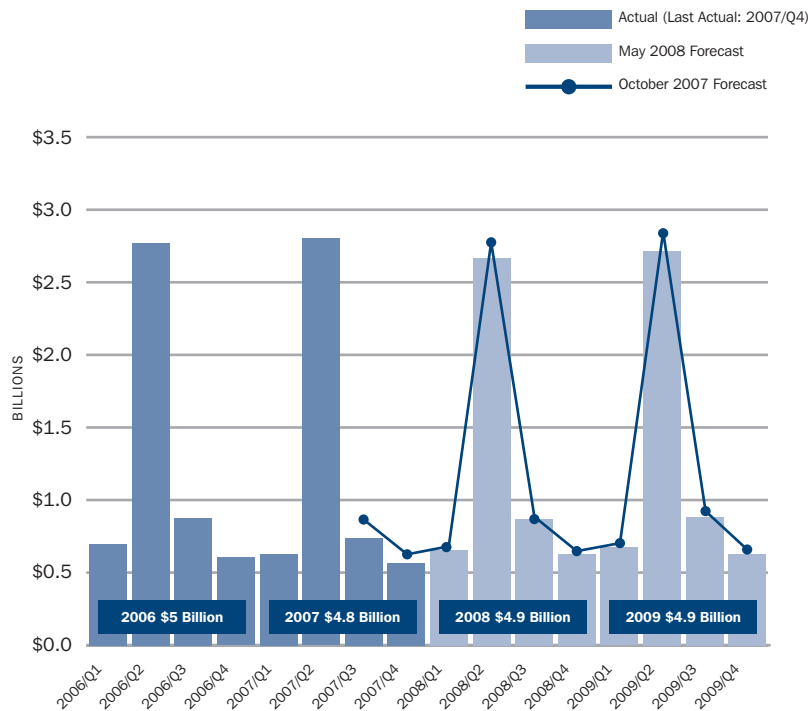
California has the largest UI system in the country. According to the U.S. Department of Labor, the California UI system provides the easiest access to benefits; covers more workers — including part-time workers; pays more claims; and pays more weeks of benefits than any other state in the nation. Other states may have a higher UI benefit, but most of them require a much stronger attachment to the labor force by requiring a longer time on the job and greater earnings before a worker becomes eligible for UI benefits.

UI Disbursements 2006–2009



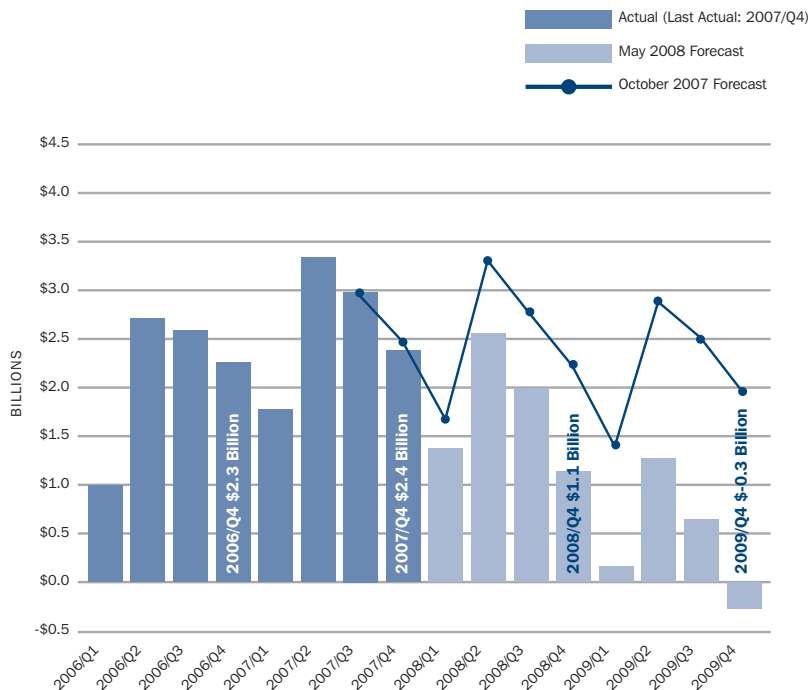
Source: California Employment Development Department

Employer UI Contributions 2006–2009



Source: California Employment Development Department

UI Fund Balance 2006–2009



Source: California Employment Development Department

UI Fund Insolvency

California employers are facing the potential of significant UI tax hikes in 2009 because the UI Trust Fund is projected to be insolvent by January 2009. The insolvency, which has been brought on by benefit increases, the loosening of eligibility standards and a down economy, has led to calls for a UI tax increase on California employers. The California Chamber of Commerce fiercely opposed a steep increase in benefits in 2001 because it was not coupled with cost-saving reforms and was likely to lead to UI fund insolvency. The increases in benefits, along with sudden and severe unemployment due to an economic downturn, have led the UI fund toward insolvency.

Current projections from the Employment Development Department (EDD) indicate that California's UI Fund could be in the red as early as January 2009. If California does not increase revenues in the fund by cutting benefits, reducing eligibility or increasing taxes on employers, the UI Fund would have to request a loan from the federal government. The federal government does have the power to increase the UI assessment on employers in California if the loan is not paid back in a timely fashion. The increase would be temporary and would go directly to paying down the principal of the loan. Any interest charged by the federal government could not be paid from the UI tax and would have to come from a different funding source.

The most likely source for funds to pay the interest would be the tax that employers pay to fund the state Employment Training Panel (ETP). The ETP provides grants to businesses to strengthen their workforces through job training. Over the last several years, the state of California has diverted hundreds of millions of ETP dollars to other state programs. The program serves to both train existing California employees and to attract new jobs to California.

Likely Action in 2009

The UI Fund's insolvency has led a number of state legislators to review options for improving the financial situation of the UI Fund. A joint information hearing was held in October 2008 by the Assembly Insurance Committee and Assembly Budget Subcommittee #5. At that hearing, a number of labor organizations called for tax increases on employ-

ers. Legislation is likely to be introduced in 2009 that contains the following provisions:

- An increase in the wage base on which the UI tax is assessed, which is currently at \$7,000.
- An increase in the UI tax rate, which is currently at 6.2 percent.
- An increased solvency surcharge that is applied when the UI Fund reserve is low.
- An increase in the UI benefits that are paid to unemployed workers. Proponents claim that this is a type of economic investment that will spur the economy.

CalChamber Position

The CalChamber believes that the best way for California to combat rising

unemployment, and therefore improve the stability of the UI Fund, is to improve the business climate in California. California ranked as the sixth worst business climate in the United States in the Milken Institute's *2007 Cost-of-Doing-Business Index*. According to that analysis, California has a cost of doing business that is 22.9 percent higher than the average state. The California Legislature has made a series of public policy choices that has led to California having a high cost of wages, a high tax burden, outrageous power costs and expensive commercial property. Any "fix" for the UI Fund has to include a series of policy changes that will improve California's business climate and spur investment and job creation.



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