Unemployment Insurance and the Bush Administration Budget:
A "New Balance," or New Marketing for Bad Ideas?
By the National Employment Law Project

Background

The Bush Administration's Fiscal Year (FY) 2003 Budget shifts the majority of responsibility for funding the administrative side of unemployment insurance (UI) benefits from the federal government to the states. While the Bush Administration has objected to the label "devolution," there is no question that its so-called New Balance proposal, if adopted, marks a fundamental, dramatic change in funding and responsibility for the federal-state UI system. When examined in detail, the Bush Administration proposal substitutes more risky state funding for stable federal financing of UI administration. Ironically, the budget doesn't produce promised employer payroll tax reductions in the long term, and it fails to guarantee that states can provide reliable services to the unemployed and employers during economic downturns.

Elements of New Balance Proposal

The Bush Administration's proposal is termed the New Balance proposal. In brief, the administration's UI proposal contains these major elements:

- Extension of Benefits. A 13-week extension of UI benefits in all states during the remainder of 2002 for workers filing initial UI claims after March 15, 2001, is proposed. This is paid for with $7 billion in federal funds.
- Tax Cut. The Federal UI payroll tax (FUTA) on employers is lowered from the current .8 percent on the first $7000 of yearly wages to .6 percent in January 2003, .4 percent in January 2005, and to .2 percent in January 2007, an overall 75 percent reduction in federal UI taxes. In practical terms, this reduces the FUTA tax from $56 per employee to $14 per employee for 2007 and following years.
- Extended Benefits Reforms. The existing Insured Unemployment Rate trigger of five percent is restored to its four percent level. Special federal rules making it harder for the long-term unemployed to get extended benefits are repealed and state UI eligibility rules will apply. This is projected to add only five states and about $500 million in EB benefits through FY 2003 and 2004. EB is funded 50 percent from a federal trust fund paid for by FUTA revenues and 50 percent from state UI trust funds.
- Reed Act Funds. The Bush Administration proposes an accelerated distribution of $9.2 billion from federal UI trust funds to state UI trust funds under an existing law, called the "Reed Act." The majority of these funds will likely reduce state UI payroll taxes for employers, although they are theoretically available for expansion of state UI benefits or administration of state UI programs. In FY 2003, there will be no Reed Act distribution, but the administration proposes a $2.5 billion Reed Act distribution from federal UI trust funds to state UI trust funds in both FY 2004 and 2005. Total proposed Reed Act distributions are $14.2 billion.
- State Responsibility for UI Administration. For FY 2003 and 2004, the Administration pledges to continue full appropriations for UI administration (projected at $3.77 and $3.83 billion in these years). Beginning in January 2005, states would be responsible for paying

one third of UI administration from state revenue sources. In January 2006, states would have responsibility for two thirds of UI administration. Beginning in January 2007, full state responsibility would occur and federal funding for state UI administration would effectively end, with the exception of federal funds for small states and other special circumstances.

How New Balance's "Bait and Switch" Approach Cuts UI Funding and Services to Unemployed Workers and Their Employers

The Bush Administration's "New Balance" proposal resembles a disreputable sales tactic, termed "bait and switch." Under this tactic, a retailer advertises certain items (the "bait") and then sells a more expensive item because the advertised item is supposedly out of stock or requires optional items or services that were not part of the advertised sales item (the "switch"). New Balance resembles "bait and switch" because it supposedly offers states, employers, and claimants a stronger UI administrative funding system. Instead, it offers shifts in already-promised, reliable federal funding to new, untested state UI administrative taxes.

1) By making roughly three year's Reed Act distributions in FY 2002 New Balance looks more attractive to states in FY 2002 (the bait), but under current law states are due to get annual Reed Act distributions of equivalent size for FY 2003 through 2007 (the switch) without New Balance. States also lose the potential for any added years of Reed Act distributions beyond FY 2005 because FUTA tax reductions end the possibility for further Reed Act distributions.
2) New Balance promises employers a federal payroll tax cut of $36.5 billion over 10 years (the bait). The FUTA surcharge is currently set to expire in 2007. Instead, New Balance leaves a .2 percent FUTA tax in place permanently beginning in 2007 (the switch). In the long run, New Balance does not amount to its advertised UI payroll tax cut, unless states do not impose equivalent state administrative taxes.
3) New Balance promises employers their long-awaited .2 percent reduction in FUTA payroll taxes (the so-called FUTA surcharge) in January 2003 (the bait). New Balance, at the same time, advertises future state UI funding levels based upon an expectation that states can impose state administrative taxes equivalent to .6 percent beginning in 2007 (the switch). This means either that a) states will impose taxes equal to the .6 percent FUTA reduction, meaning that employers are not getting any overall UI administrative tax cut, or b) states will face employer opposition if they seek to maintain administrative funding equal to that currently provided by FUTA and cannot count on New Balance's funding levels as advertised by the Administration.
4) New Balance promises workers and employers similar funding and services to that available under current federal administrative funding (the bait). After FY 2004, states do not get the full UI administrative funding they will get under the current federal UI system, and after FY 2007 they lose any continued promise of federal UI administrative funding (the switch). Cuts in services to unemployed workers are the likely result of New Balance.
5) New Balance assumes that Congress will continue appropriating UI administrative funding (the bait) despite billions in accelerated Reed Act distributions (the switch) in FY 2002, 2004, and 2005.

Key Advantages of Federal UI Administrative Funding

New Balance does not take into account the advantages of federal UI administrative financing. Currently, the federal government collects a federal (FUTA) tax that is used to pay for operating all 53 state UI agencies as well as the federal share of Extended Benefits, funding a federal loan account, and supporting U.S. Department of Labor oversight of UI. While the loan account and EB account continue under the "New Balance" proposal, our federal-state UI system provides essential help for state UI programs that will be ended under New Balance. Here are some significant advantages of our current UI system:

- Helps States with Weak Economies. Pooling of UI administrative funding enables states with strong economies to support other states with weaker economies and higher unemployment claims. New Balance leaves states on their own.
- Keeps administrative funding out of competition with UI benefits and state payroll taxes. Currently, UI benefits and state UI payroll taxes must compete with each other as state legislatures set UI tax and eligibility rules. After New Balance, administrative funding will be added to the mix and forced to compete with the rest of UI for resources.
- No Need for State Administrative Reserves. States need not have administrative funding reserves or raise UI administrative taxes during a recession under current law. Under New Balance, states can either create an administrative reserve or they'll be forced to raise taxes or cut services to handle UI claims during recessions.
- Limits on State Taxes Avoided. Administrative financing is not subject to constitutional limitations on state taxes, including referenda, which exist in at least 13 states. New Balance requires states to impose new state taxes for UI administrative funding, a difficult task in many states.
- Automatic Funding with UI Claims Increases. States now get automatic increases in federal UI administrative funding when UI claims rise above expected levels. States will have to raise taxes, use general revenue, or cut services when UI claims rise after New Balance.
- State Budget Restrictions. Federal administrative funding is not subject to direct appropriation at the state level and often permits hiring of additional staff despite state budgetary restrictions or hiring freezes. After New Balance, state UI agencies will compete with all other state programs and agencies for appropriations and tax authority.
- Helps Small States. States with smaller populations and bigger geographic areas have been helped by federal UI administrative formulas to maintain larger state employment security agencies than otherwise justified by their employment levels. Recognizing this problem, New Balance provides 10 years of supplemental funding for small states. After these ten years have passed, New Balance leaves these small states on their own.

The Real Issues with UI Administrative Financing

New Balance addresses a real problem with a faulty solution. The genesis of New Balance is decades of restrictions on state UI administrative funding by the federal government. These restrictions arise fundamentally because federal and state UI trust funds are included in the federal unified budget and not permitted by Congress to operate as intended. Our UI programs are designed to build up reserves during economic recoveries and spend those funds during recessions. Congress consistently underfunds the operation of UI programs for budgetary reasons. Appropriations are smaller than indicated by UI claims levels because UI administration competes with all other discretionary spending.

Funding issues won't stop under the Administration's proposal because New Balance does not address the root problems of UI administrative funding shortfalls. Two reforms are key. First, UI programs should be excluded from the federal budget, as recommended by the Advisory Council on Unemployment Compensation in 1995 and the National Commission on Unemployment Compensation in 1980. Second, UI administrative funding should be moved to the mandatory side of the budget, as provided in the 2000 stakeholders agreement.

Conclusion

Unemployment insurance is the first line of defense for our economy during recessions. Without UI benefits, families, communities, and our states' economies suffer when layoffs occur. Maintaining prompt payment of UI benefits, collection of payroll taxes, and operation of job placement offices are important responsibilities that should be shared by our federal and state governments. New Balance fails to improve our UI administrative funding system because it doesn't ensure that states will have the tools to collect and maintain adequate UI state administrative funds and it withdraws essential back up functions provided by the federal partner. New Balance is not a realistic answer to our longstanding UI administrative problems.

For Further Information

Advisory Council on Unemployment Compensation, **Defining Federal and State Roles in Unemployment Insurance** (Washington, D.C., 1996)

National Employment Law Project, **Background Paper on Extended Benefits: Restoring Our Unemployment Insurance Safety Net for Workers and Communities Impacted by Long Term Unemployment** (March 2001) http://www.nelp.org/pub66.pdf.

National Employment Law Project, **Background Paper on Federal Extended Benefit Restrictions' Impact on Regular State UI Programs** (March 2001) http://www.nelp.org/pub62.pdf.

National Employment Law Project, **Questions and Answers About FUTA Taxes** (April 2001) http://www.nelp.org/pub93.pdf.

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