

## **Testimony of George Wentworth**

National Employment Law Project

### **Testimony in Opposition to:**

- ***Proposed Bill 5851, An Act Concerning Unemployment Compensation Reform***
- ***Proposed Bill 436, An Act Concerning the Waiting Week and Unemployment Benefits***
- ***Proposed Bill 5864, An Act Concerning Unemployment Compensation and Time-Specific Work Assignments***

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## **Hearing before Connecticut General Assembly Committee on Labor and Public Employees**

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My name is George Wentworth. I am a Senior Staff Attorney with 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 maximize program access for low-wage workers and improve income security for all workers. Prior to joining NELP in 2009, I worked at the Connecticut Department of Labor for 35 years where I oversaw development of unemployment insurance policy and regulations.

I am testifying this evening in opposition to three unemployment insurance bills -- Proposed Bill 5851, *An Act Concerning Unemployment Compensation Reform*, Proposed Bill 436, *An Act Concerning the Waiting Week and Unemployment Benefits*, and Proposed Bill 5864, *An Act Concerning Unemployment Compensation and Time-Specific Work Assignments*. Each of these bills is intended to reduce unemployment insurance costs for employers but each also imposes unnecessary hardship on the unemployed workers that the program is intended to serve.

These bills have been proposed in response to the insolvency of the Connecticut Unemployment Trust Fund. Like most other states, Connecticut's trust fund was not prepared for extraordinarily high volumes of claims during the Great Recession and the long ensuing recovery. And like most other states, Connecticut was required to borrow from the federal government to pay benefits and now employers are paying higher federal unemployment taxes as that debt is recouped. While the scope and depth of the recession was unprecedented in the nearly 80-year history of the state's unemployment insurance program, it is equally clear that more could and should have been done to shore up the program's financing before the recession. Specifically, Connecticut addressed its last solvency crisis responsibly by gradually increasing the wage base on which taxes are imposed throughout the 1990's until it reached \$15,000 in 1999. But because the taxable wage base has not kept pace with rising wages since, the trust fund was only half as solvent as it should have been entering the recession in 2007.

Now that the economic storm has passed, the road back to solvency should not be based on benefit cuts that undermine the core purpose of the program and hurt workers and their families already struggling to get back to some level of economic security. It is important to fix a basic problem in the financing of the system now so that the program is better able to handle the inevitable next economic downturn. A discussion of UI financing is included at the end of this testimony.

## Purpose of Unemployment Insurance

Social insurance experts, economists and a bi-partisan federal commission have all identified four related purposes for unemployment insurance (UI):

- Income replacement 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.
- Support for job search and matching of laid off workers to jobs that better fit their skills, training, and past work.
- Retaining attachment to the labor market and specific employers during temporary layoffs.<sup>1</sup>

To serve these significant social purposes, UI benefits are paid by virtue of prior employment and as a matter of right under conditions largely established by state UI laws. Unemployment insurance is the first line of defense against the economic impact of wage loss due to unemployment. UI benefits keep food on the table, help pay rent and mortgages and cover health care costs.

Unemployment insurance dramatically reduced the prevalence of poverty among the population who received them in the Great Recession and ensuing recovery. In 2010, for example, over one quarter (27.5%) of unemployed Americans who received UI benefits would have been considered poor prior to counting the UI benefits they received; after counting UI benefits, their poverty rate was cut by well over half, to 12.5%.<sup>2</sup>

Mark Zandi, chief economist for Moody's Economy.com, studied the economic impact of various forms of government outlays during the previous recession and testified in February 2012 before the U.S. Joint Economic Committee that each dollar of unemployment insurance spent generates \$1.55 in economic activity. In addition, another major study covering five recessions concluded that each dollar of UI benefits

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<sup>1</sup> See *Advisory Council on Unemployment Compensation, Defining Federal and State Roles in Unemployment Insurance* (1996) p.7

<sup>2</sup> Congressional Research Service Report to Congress, *Antipoverty Effects of Unemployment Insurance*, October 16, 2012. p. 22.

produces \$2.15 in economic growth because such a substantial portion of unemployment benefits are spent on basic goods and services.<sup>3</sup>

### **How did Connecticut's UI program perform during the Great Recession and the ensuing recovery?**

Connecticut's unemployment rate, which stood at 5.0 percent at the beginning of 2008, reached 9 percent at the end of 2009. It remained above 9 percent until August 2011 and did not fall below 8 percent until February of 2013. Throughout this period, the Connecticut UI program was vital to the state's economic stability. In addition to the basic 26-week state UI program, Congress authorized two extension programs (Extended Benefits and Emergency Unemployment Compensation), which provided additional weeks of federally funded benefits at different levels between July 2008 and the end of 2013.

In CY 2009, Connecticut paid out over \$1.3 billion in state benefits<sup>4</sup> to over 223,000<sup>5</sup> Connecticut workers. This represented an increase of 80 percent over CY 2008 when the system paid out \$743 million in state benefits.<sup>6</sup> Benefit payments fell to approximately \$1.04 billion in CY 2010<sup>7</sup> before declining again in CY 2011 to \$893 million, where they essentially remained in CY 2012.<sup>8</sup> As the state's average unemployment rate skyrocketed in 2009, UI benefits doubled as a percentage of the state's total payroll.<sup>9</sup>

Over the past seven years, the Connecticut Department of Labor made roughly 1.1 million first payments to the state's unemployed. As the following table illustrates, the state trust fund paid out roughly \$6.5 billion in state benefits between 2008 and 2014, while an additional \$4.8 million was paid under the two federal extension programs that ended in 2013. As the state's economy recovers, both benefits and first payments are now trending toward the pre-recession levels of 2007. Clearly, the

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<sup>3</sup> Lawrence Chimerine et al. *Unemployment Insurance as an Economic Stabilizer: Evidence of Effectiveness over Three Decades*, Unemployment Insurance Occasional Paper 99-8

<sup>4</sup> U.S. Department of Labor, *Handbook 394*, <http://www.workforcesecurity.doleta.gov/unemploy/hb394.asp>.

<sup>5</sup> Estimated from first payments for 2009, U.S. Department of Labor, *Monthly Program and Financial Data*, <http://www.workforcesecurity.doleta.gov/unemploy/claimssum.asp>.

<sup>6</sup> U.S. Department of Labor, *Handbook 394*.

<sup>7</sup> U.S. Department of Labor, *Handbook 394*.

<sup>8</sup> U.S. Department of Labor, *Handbook 394*.

<sup>9</sup> Benefit payments represented 0.87 percent of CT total wages in 2008 and 1.72 percent in 2009. Calculations based on U.S. Department of Labor, *Handbook 394*.

Connecticut unemployment insurance program played a key role in moderating the impact on the state's economy of the worst recession since World War II.

	<b>First Payments</b>	<b><u>Benefits Paid (millions)</u></b>			<b>Total</b>
		<b>State</b>	<b>EUC</b>	<b>EB</b>	
2008	153,263	\$743	\$143	\$0	\$886
2009	223,342	\$1,337	\$765	\$92	\$2,194
2010	174,314	\$1,047	\$1,150	\$291	\$2,488
2011	161,793	\$893	\$891	\$243	\$2,027
2012	146,518	\$880	\$698	\$74	\$1,652
2013	146,208	\$847	\$539	\$0	\$1,386
2014	137,079	\$783*	\$0	\$0	\$783*
<b>Total</b>	<b>1,142,517</b>	<b>\$6,530</b>	<b>\$4,186</b>	<b>\$700</b>	<b>\$11,416</b>

\*Estimated.

### **Proposed Bill 5851: Four-Quarter Averaging**

Bill 5851 proposes a change in the statutory formula for calculating a claimant's UI weekly benefit amount that would unnecessarily harm a very large percentage of unemployed workers filing for UI benefits. 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 52. This formula is generally calibrated to produce a weekly benefit amount that equals roughly half of the worker's pre-layoff weekly wage, based on an average of the two highest quarters of wages in the base period.

Before 1993, Connecticut applied a formula that called for dividing the claimant's single highest quarter of base period wages by 26 to calculate a weekly benefit rate. The single high-quarter formula is still used in 23 states and is the most common nationally. As part of an effort to restore trust fund solvency in 1993, the legislature changed to the 2-high-quarter formula for the purpose of reducing the average weekly benefit. This effort was successful as the average benefit dropped by approximately 5 percent in the first year after implementation in 1994. Two-quarter averaging is the second most common method for calculating unemployment benefits with 17 states considering the 2 highest base period quarters in their statutory formulas.

Bill 5851 would change Connecticut's 2-quarter formula further by averaging the earnings in all four quarters of the base period.<sup>10</sup> By taking into account the other two quarters, weekly benefit amounts will decrease for claimants who have had breaks in employment or fluctuation in wages for any reason – whether because of unemployment, sporadic or seasonal work schedules, unpaid family or medical leave or gaps between work assignments. This would place Connecticut among a small group of outlier states using the most severe method for calculating weekly unemployment insurance benefits. Only five states – Arkansas, Indiana, Kentucky, Louisiana and West Virginia – use a 4-quarter average formula to calculate benefits.<sup>11</sup>

Connecticut has, to date, relied on the mainstream approach of averaging the claimant's two highest quarters of base period earnings to get an accurate picture of what the worker's weekly income looked like before being laid off. Using this approach, the average weekly benefit amount is \$344 which is 14<sup>th</sup> nationally in a state with the country's third highest weekly wage. A jobless Connecticut worker's unemployment benefit typically replaces only 42 percent of what he earned before layoff. But by shifting to 4-quarter averaging under this proposal, any jobless worker who does not already qualify for maximum benefits and who has any recent deviation in quarterly wages would see a drop in benefits. Consider the following example:

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<sup>10</sup> While the language is less clear, it appears that Proposed Bill 434; *An Act Concerning Unemployment Compensation Calculations* may be intended to achieve the same purpose.

<sup>11</sup> *Significant Provisions of State Unemployment Insurance Laws*, USDOL, Employment & Training Administration, July 2014.

**Example**

Claimant has base period earnings of \$34,000. Wages are spread out over 4 quarters as follows:

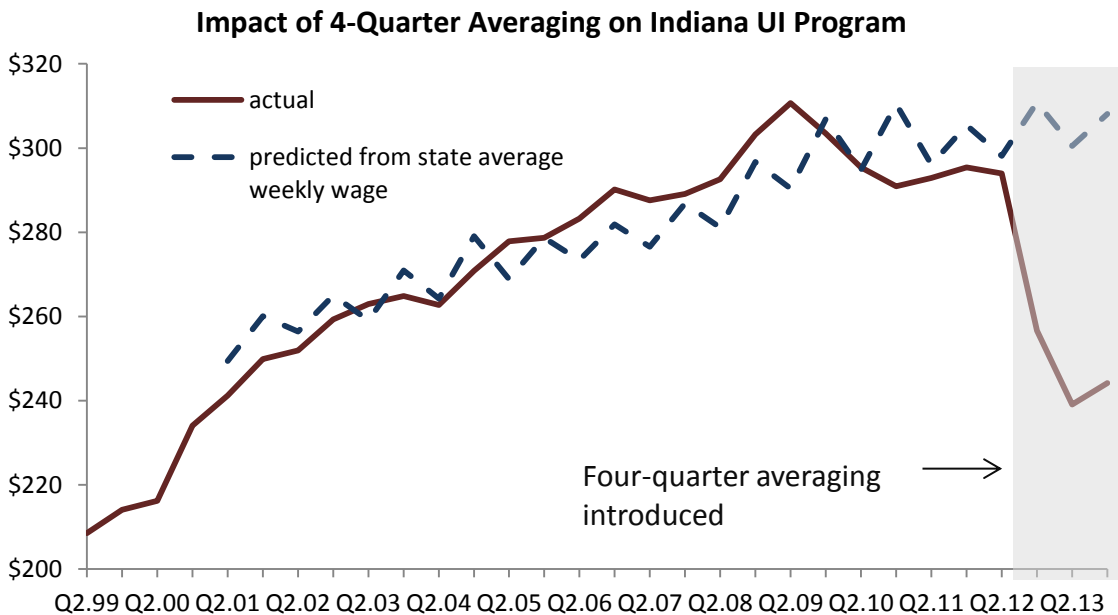
Q1	Q2	Q3	Q4
5000	8000	10,000	11,000

Under current law, the 2 high quarters of \$10,000 and \$11,000 are added and divided by 52. Since \$21,000 divided by 52 = 403, the claimant is entitled to **\$403** per week.

Under the proposed law change, the claimant’s total base period wages (\$34,000) are divided by 104 (or in the alternative, an average quarterly base period wage of \$8,500 is divided by 26), and the resultant weekly benefit amount is **\$326**.

Thus, under Proposed Bill 5851, the unemployed worker whose \$34,000 in wages currently qualifies her for a weekly benefit of \$403 sees *a cut of \$77 per week* based on the same exact wages.

The last state to implement 4 –quarter averaging was Indiana in 2012. Prior to implementation, Indiana’s average weekly benefit amount was \$295, which was 28<sup>th</sup> highest in the nation. Now that 4-quarter averaging has been in place for two years, the average UI benefit in Indiana is \$250, a decline of more than 15 percent and a rate that ranks 43rd nationally. See the following chart:



The idea of determining an unemployed worker's average wage based on all four quarters of a recent work history is particularly harsh policy at this point in the recovery. Many of those who lost good family-sustaining jobs during the recession are still struggling to get back on their feet. Many have taken jobs that pay far less than what they were earning before the recession. A report published by NELP last year underscores the nature of the nation's low-wage recovery. While employment losses between 2008 and February 2010 occurred throughout the economy, 78 percent of jobs lost were in high-wage and mid-wage industries. However, the report found that only 56 percent of jobs recovered since then were in those same industries, while 44 percent were in low-wage industries (where the median wage was less than \$13.33 per hour).<sup>12</sup>

In addition, many workers are working part-time when they want to be working full-time. Part-time workers represent 22.2 percent of the Connecticut workforce, but the percentage who are working part-time involuntarily grew from 2.9 percent before the recession to 4.7 percent in 2012.<sup>13</sup> These workers are frequently subject to unexpected changes in their scheduled hours, resulting in fluctuation in wages between quarters. Workers in the temporary industry, often the best available opportunity for a jobless workers trying to find the way back into secure full-time employment, experience similar wage fluctuations as they experience gaps between assignments. Under current law, workers with part-time and temporary work histories already experience 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.

Finally, this proposal would dramatically reduce the benefits of seasonal workers. Like every other state, Connecticut relies on a number of industries that are seasonal in nature to sustain its economy. Slashing the safety net for workers for whom available work weeks are curtailed by weather only undermines the ability of Connecticut citizens to make a living in these industries, which in turn, threatens the viability of the employers in these industries.

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<sup>12</sup> *The Low-Wage Recovery: Industry Employment and Wages Four Years into the Recovery*, National Employment Law Project, April 2014.

<sup>13</sup> Krzyzek, Matthew, *Part-Time Employment Trends: An Update*, Connecticut Economic Digest, May 2014.



## **Proposed Bills 5851 and 436 – Waiting Week**

NELP opposes the adoption of the “waiting week” provision in Proposed Bill 5851 and Proposed Bill 436. 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 26<sup>th</sup> 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. So under this proposal, over 63 percent of Connecticut workers would lose a week of unemployment insurance for which they would otherwise qualify under existing law.

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, Connecticut has wage information available electronically and it is administratively feasible to timely pay UI benefits for the first week of unemployment.

So why do most states have waiting week provisions? Most states with waiting week provisions adopted them in the 1980’s in response to a federal incentive – Congress enacted a law that said the federal government would not pay its usual 50 percent share for the first week of Extended Benefits (EB) to states without a waiting week. This incentive, however, proved illusory; unemployment rate triggers for the revised EB program were set too high and the funding issue has never come into play. Congress has fully funded any EB benefits paid in Connecticut over the past 30 years.

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 Connecticut wants to embrace? At a time when roughly 37% of UI claimants in Connecticut 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. Connecticut 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 Connecticut'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.

**Proposed Bill 5864: Disqualification of workers with time-specific work assignments**

Proposed Bill 5864 would result in the denial of unemployment insurance to “persons hired for a specific time period ... beyond the time period specified.” This bill would undermine one of the basic objectives of the UI program – to provide partial wage replacement to workers with recent work histories who become involuntarily unemployed. In all states, unemployment insurance law provides that a worker who is laid off for lack of work or for some other economic reason is presumptively eligible for benefits, so long as he or she has earned sufficient recent wages and is able and available for work. On the other hand, a worker who voluntarily leaves employment is generally ineligible for benefits unless the reason for leaving constitutes good cause connected with the work under state law.

This bill would appear to disqualify workers with time-specific employment agreements. This would encompass all workers employed by temporary help firms and placed with client companies for a fixed period of time. It would also seem to apply to any employee whose employment has an end date. This is a very large segment of the workforce. In addition to the temporary industry, it would likely entail most seasonal work and any situation where an employer – for reasons of funding or for other reasons – hires employees through a fixed duration contract. This is a very common practice in the private, public and non-profit sectors.

Connecticut's UI program has always been guided by the basic principle, articulated in decisions by the Connecticut Supreme Court, that when a contract of employment comes to an end, the worker's unemployment is not voluntary and the worker is presumptively eligible for unemployment insurance.

The fact is that in this economy, many workers who have lost good jobs are more likely to experiment with temporary industry employment as a possible route to eventual permanent work.

Sarah Forbes Raskin, a Governor of the Federal Reserve System, made the following observations:

Many employers are looking to make the employment relationship more flexible, and so are increasingly relying on part-time work and a variety of arrangements popularly known as "contingent work." This trend toward a more flexible workforce will likely continue. For example, while temporary work accounted for 10 percent of job losses during the recession, these jobs have accounted for more than 25 percent of net employment gains since the recession ended. In fact, temporary help is rapidly approaching a new record, and businesses' use of staffing services continues to increase.

Contingent employment is arguably a sensible response to today's competitive marketplace. Contingent arrangements allow firms to maximize workforce flexibility in the face of seasonal and cyclical forces. The flexibility may be beneficial for workers who want or need time to address their family needs. However, workers in these jobs often receive less pay and fewer benefits than traditional full-time or "permanent" workers, are much less likely to benefit from the protections of labor and employment laws, and often have no real pathway to upward mobility in the workplace.

Many workers who hold contingent positions do so involuntarily. Department of Labor statistics tell us that 8 million Americans say they are working part-time jobs but would like full-time jobs. These are the people in our communities who are "part time by necessity." As businesses increase their reliance on independent contractors and part-time, temporary, and seasonal positions, workers today bear far more of the responsibility and risk for managing their careers and financial security. Indeed, the expansion of contingent work has contributed to the increasing gap between high- and low-wage workers and to the increasing sense of insecurity among workers.<sup>14</sup>

As a matter of public policy, we should encourage the industry and initiative of unemployment insurance claimants who are adapting to the changing labor market and taking a risk on temporary and other contract work in the hopes that it will become permanent. There is no good reason to treat the temporary industry more favorably under state UI law; in fact, it stands to reason that an industry whose primary product is contracted labor should expect that unemployment insurance charges will be part of its

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<sup>14</sup> Raskin, Sarah Bloom, *Focusing on Low- and Moderate-Income Working Americans*, Speech at the National Community Reinvestment Coalition Annual Conference, Washington, D.C. , March 2013, <http://www.federalreserve.gov/newsevents/speech/raskin20130322.htm>.

cost of doing business – a cost that can be recovered contractually from client employers.

Unemployment insurance benefits are intended to help the jobless worker get back into the labor market as close as possible to the employment from which the worker was originally displaced. A fair and responsible unemployment insurance program encourages workers to explore as many options as possible to get back to economic stability but does not penalize them for having made the effort.

### **Unemployment Insurance Financing**

Since 2008, 35 states have borrowed more than \$45 billion from the U.S. Treasury, which far surpassed the prior record borrowing of the early 1980's. There is still almost \$14 billion in outstanding debt and Connecticut is one of nine states with an outstanding loan (currently \$431 million). In addition, eight states are borrowing in the private securities market, accounting for almost another \$10 billion.<sup>15</sup>

How did states get in this situation? The obvious answer is both the depth and duration of the recent economic downturn. Unemployment peaked at 10 percent in 2010 while the number of unemployed workers exceeded 15 million for several months. The economy took close to six years to return to pre-recession employment levels. In comparison, employment returned to pre-recession levels within four years of the onset of the 2001 recession and back-to-back recessions of the early 1980s.

Another unique aspect of the current downturn is the emergence of epidemic long-term unemployment. Nationally, the average duration of all unemployed workers was just over 39 weeks in 2012, essentially unchanged from a year earlier. Even today, almost a third of all unemployed workers have been without work for 27 weeks or longer. As a result of prolonged unemployment spells, the percentage of unemployed workers exhausting state benefits reached a historic high of 55% in 2009 and, stands at over 41% today, well above historic norms. Nationwide, the estimated average duration for unemployed workers receiving regular state and federal benefits was 35 weeks in FY 2012.<sup>16</sup>

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<sup>15</sup> U.S. Department of Labor, <http://www.workforcesecurity.doleta.gov/unemploy/budget.asp#tfloans> (accessed January 16, 2012).

<sup>16</sup> *UI Outlook FY 2013 Budget Midsession Review*, Key Data -- FY 2012/FY 2013.

The severity of the Great Recession contributed to the depletion of state trust funds, but was not the only factor driving unprecedented borrowing. 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.<sup>17</sup> 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%<sup>18</sup> and half the amount recommended by UI financing experts.<sup>19</sup> 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

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<sup>17</sup> U.S. Department of Labor, *Handbook 394*, <http://www.workforcesecurity.doleta.gov/unemploy/hb394.asp>.

<sup>18</sup> U.S. Department of Labor, *Handbook 394*.

<sup>19</sup> Evangelist, Michael, 2011, “Lessons Left Unlearned,” New York, NY: National Employment Law Project, [http://www.nelp.org/page/-/UI/2012/Report\\_UI\\_Solvency.pdf](http://www.nelp.org/page/-/UI/2012/Report_UI_Solvency.pdf).

and larger tax withdrawals than benefit payments during economic expansions.<sup>20</sup>

Under the same rationale, cutting UI benefits or raising UI payroll taxes during a recession undermines the positive economic impact of UI. NELP supports 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. In our view, Connecticut should recommit to forward financing (as it did in the 1990's) as a first step toward addressing its current solvency dilemma.

Traditional forward funding of UI has significant advantages. Maintaining adequate state trust fund balances permits states to receive significant federal interest payments on those trust fund balances. States that have abandoned forward financing, whether consciously or not, have lost out on federal interest payments which could have been relied upon to pay UI benefits during a recession.

As is often the case, states that borrowed during the downturn faced interest and loan repayment penalties before their economies were fully recovered. Long-term federal loans cost indebted states \$2.8 billion in 2012, including interest payments of \$1.1 billion and \$1.7 billion of FUTA credit reductions.<sup>21</sup>

In addition, since states with solvency concerns face pressures to make cuts on the benefits side of the UI cost equation, states with adequately financed trust funds can avoid these pressures. Just as tax increases during a recession are bad policy, benefit cuts or freezes undercut the positive economic impact of UI programs.

A key concept in measuring trust fund solvency is known as the Average High Cost Multiple (AHCM). A High Cost Multiple (HCM) of 1.0 means that a state has adequate reserves in its fund to pay out benefits for one year at its historically highest level of benefit payments without relying on any new payroll tax revenues. An *Average* High Cost Multiple of 1.0 means the state is able to pay a year of benefits at a level equal to the average payout in the three high payout calendar years during the past three recessions or twenty years.

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<sup>20</sup> Wayne Vroman (1998), *Topics in Unemployment Insurance Financing*, p. 10.

<sup>21</sup> U.S. Department of Labor, *UI Outlook FY 2013 Budget Midsession Review*, Status of Loan Accounts, <http://www.ows.doleta.gov/unemploy/pdf/MSR.pdf>.

In 1995, the Advisory Council on Unemployment Compensation, a federal advisory panel, recommended that states maintain a pre-recession AHCM of 1.0. Generally, this has been the measure of solvency utilized by the USDOL in recent years. In CY2000, 30 states<sup>22</sup> (including Connecticut had accumulated the recommended level of savings (AHCM of 1.0).<sup>23</sup> By CY2007, only 19 states met this solvency standard. Connecticut's UI trust fund entered the Great Recession with \$598 million in reserves –slightly more than half the \$1.1 billion needed to meet the federal solvency standard.

Of the 19 states that met the solvency standard in 2007, only six required a federal loan and three of these states were able to repay their loans quickly. In comparison 30 of the 34 states with inadequate reserves borrowed.<sup>24</sup> NELP estimates that had the 34 states that started the recession with inadequate reserves met the AHCM solvency benchmark, the number of borrowing states would have fallen to 13 with the total amount borrowed dropping to \$9 billion by the end of 2010.<sup>25</sup> Even though the Great Recession was severe, adequately prepared trust funds would have allowed most states to weather the storm without resorting to loans, while dramatically reducing the amount borrowed in those states that still required federal assistance.

Only wages below an annual threshold known as the “taxable wage base” are subject to state UI payroll taxes. NELP has long identified the annual, automatic adjustment of UI wage bases (known as “indexing”) as a key UI financing policy. Closely related to indexing is maintaining a higher taxable wage base level. All states with higher taxable wage bases have indexing. For this reason, indexing and higher taxable wage bases are addressed in tandem.

Of the 16 states with indexed taxable wages in 2007, ten were considered adequately prepared for the recession, while only 8 of 35 non-indexed states met the solvency standard.<sup>26</sup> States with indexed taxable wage bases also outperformed non-indexed states with only six (38%) requiring a loan during the downturn, compared to 29 (83%) of the non-indexed states.<sup>27</sup> Only two of the top ten largest states have an indexed taxable wage base, which is unfortunate given the fact that the largest twelve states

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<sup>22</sup> For purposes of this testimony, “states” encompasses all 53 unemployment insurance jurisdictions, including the District of Columbia, Puerto Rico, and the Virgin Islands.

<sup>23</sup> U.S. Department of Labor, *Handbook 394*.

<sup>24</sup> Evangelist, 2012.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid. (counts exclude Puerto Rico and Virgin Islands)

<sup>27</sup> Vroman, Wayne, 2012, “The Challenges Facing the UI Financing System.” Washington, DC: Urban Institute, <http://www.urban.org/UploadedPDF/412629-the-challenge.pdf>.

accounted for over three-quarters of the total amount borrowed in 2012.<sup>28</sup> It is no coincidence that Washington, the largest state to avoid borrowing, also has an indexed taxable wage base.

In 2013, taxable wage bases range from a high of \$39,800 (WA) to three programs with taxable wage bases at the federally allowed minimum of \$7000 (AZ, CA, and PR).<sup>29</sup> A total of 20 states have taxable wage bases of \$10,000 or less.<sup>30</sup> Notably, while a majority of states have maintained low taxable wage bases, 18 programs had taxable wage bases over \$20,000 in 2013.<sup>31</sup> All of these states had indexing. See chart.

### State Taxable Wage Bases

\$10,000 or less	Over \$10 to \$15 K	Over \$15 to \$20K	Above \$20K
(20 States)	(14 States)	(1 State)	(18 States)
Alabama, Arizona, California, District of Columbia, Florida, Georgia, Indiana, Kansas, Kentucky, Louisiana, Maryland, Michigan, Nebraska, New York, Ohio, Pennsylvania, Puerto Rico, Tennessee, Texas, and Virginia	Arkansas, Colorado, Connecticut, Delaware, Illinois, Maine, Massachusetts, Mississippi, Missouri, New Hampshire, South Carolina, South Dakota, West Virginia, and Wisconsin	Vermont	Alaska, Hawaii, Idaho, Iowa, Minnesota, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, Utah, Virgin Islands, Washington, and Wyoming

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 18 states with indexing, the formula ranges from 100 percent in Idaho to 46.5 percent in Rhode Island, with a couple of states using less common methods.<sup>32</sup> (See following chart.) Indexing promotes UI solvency in a couple of important ways. The strongest rationale for indexing is that weekly benefit amounts increase each year due to growth in wages. This growth in benefit levels is especially true in states that index

<sup>28</sup> Borrowed amount includes those states that issued bonds in the private debt market. See Evangelist, 2012.

<sup>29</sup> U.S. Department of Labor, *Significant Provisions of State UI Laws*, July 2011, <http://www.workforcesecurity.doleta.gov/unemploy/content/sigpros/2010-2019/July2011.pdf>.

<sup>30</sup> U.S. Department of Labor, *Significant Provisions of State UI Laws*.

<sup>31</sup> U.S. Department of Labor, *Significant Provisions of State UI Laws*. Count includes the Virgin Islands.

<sup>32</sup> U.S. Department of Labor, *Comparison of State UI Laws*, Chapter on Financing, Table 2-2: Computation of Flexible Taxable Wage Bases, <http://www.workforcesecurity.doleta.gov/unemploy/comparison2013.asp>. Count includes the Virgin Islands.



maximum weekly benefit amounts, like Connecticut.<sup>33</sup> But, even where maximum weekly benefit amounts are fixed and require legislative amendments, benefit amounts increase because of the growth in wages. As a result, average benefit payouts rise without any legislative action.

**States with Indexed Taxable Wage Bases**

<b>2013 Taxable Wage Base</b>	<b>State</b>	<b>Indexing Criterion</b>
\$36,900	Alaska	75% SAAW
\$39,600	Hawaii	100% SAAW
\$34,800	Idaho	100% SAAW
\$26,000	Iowa	66.7% AWW times 52
\$29,000	Minnesota	60% SAAW
\$27,900	Montana	80% SAAW
\$26,900	Nevada	66.7% SAAW
\$30,900	New Jersey	28 times AWW
\$22,900	New Mexico	60% SAAW
\$20,900	North Carolina	50% SAAW
\$31,800	North Dakota	70% SAAW
\$20,100	Oklahoma	50% SAAW
\$34,100	Oregon	80% SAAW
\$20,200	Rhode Island	46.5% SAAW
\$30,300	Utah	75% prior fiscal year wage
\$23,600	Virgin Islands	60% SAAW
\$39,800	Washington	115% of prior TWB but not more than 80% SAAW
\$23,800	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 (2013), Table 2.2.

The obvious impact of paying for rising UI benefit levels on a fixed taxable wage base is aptly described by economist Philip Levine. "A major deficiency in the current

<sup>33</sup> U.S. Department of Labor, *Comparison of State UI Laws*, Chapter on Monetary Entitlement, Table 3-6: States with Automatic Adjustments to Benefit Amounts, <http://www.workforcesecurity.doleta.gov/unemploy/pdf/uilawcompar/2013/monetary.pdf>

system of UI financing is that the infrequent, ad hoc adjustments to the taxable wage base lead to a continual erosion of its financial stability . . . . Even in the absence of severe cyclical downturns, these basic relationships indicate that the current system of UI financing will drift toward insolvency."<sup>34</sup>

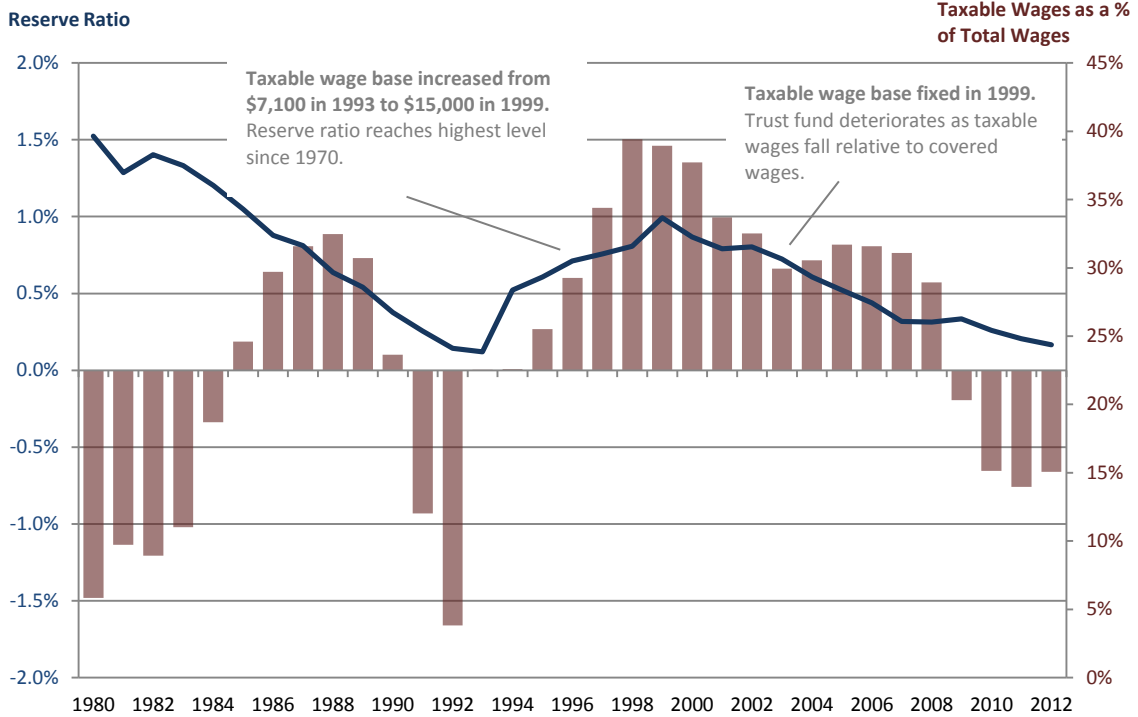
Conversely, higher taxable wage bases put UI financing on a broader basis and increase the responsiveness of UI taxes when recovering from higher UI payments during a recession. Wayne Vroman has shown there is a strong correlation between taxable wage base levels and the ability of states' UI financing mechanisms to produce sufficient revenues to maintain solvent trust fund reserves during a recession. Similarly, the Advisory Council on Unemployment Compensation found from its studies that increasing state taxable wage bases was associated with improvements in the solvency of UI trust funds, as measured by reserve ratios. In short, Connecticut needs further increases in its taxable wage levels over time in order to reach and maintain adequate forward financing of its UI Trust Fund. More importantly, the single most important step toward long-term UI financial solvency would be indexing its taxable wage base.

### **A Connecticut Solution**

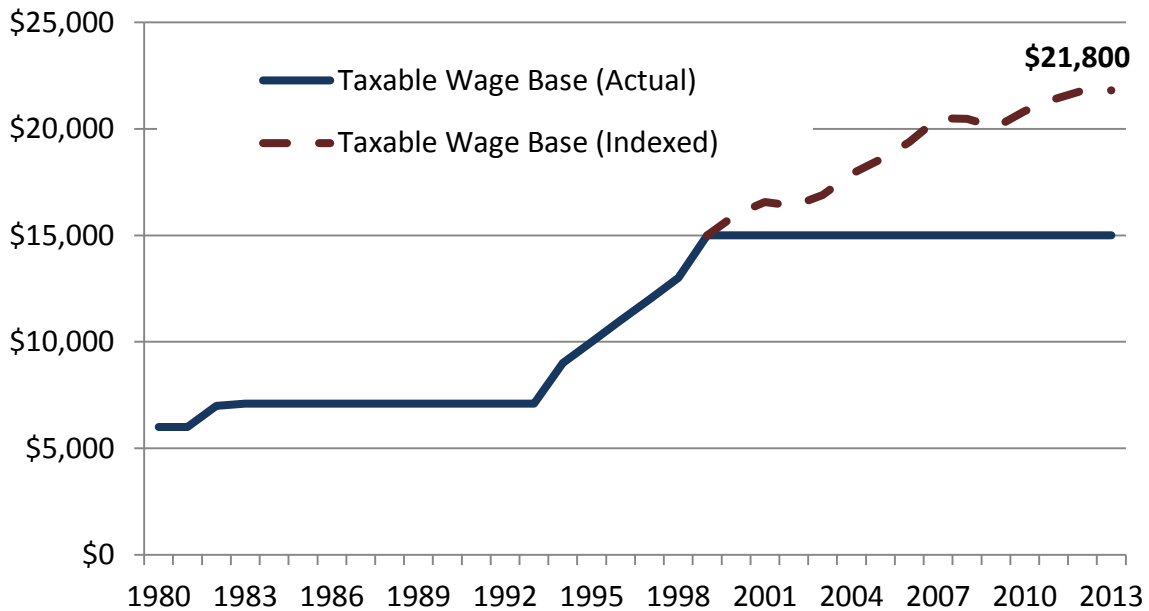
Twenty-two years ago, faced with the insolvency of Connecticut's UI trust fund created by another recession, this Committee took the lead in crafting legislation that not only eliminated hundreds of millions of dollars of debt but also put the fund on a path toward sustained solvency. That solution was predicated on gradually increasing the taxable wage on which employers pay their UI taxes from the first \$7100 in earnings in 1994 up to the first \$15,000 in wages by the end of the decade. It was smart legislation, but it did not include an indexing feature. As a result, fund solvency began to erode early in the last decade and stood at only slightly more than half of the federally recommended level entering the recession in 2007. See table below.

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<sup>34</sup> Phillip B. Levine, "Financing Benefit Payments," in *Unemployment Insurance in the United States: Analysis of Policy Issues*, (Christopher O'Leary & Stephen A. Wandner, ed. Upjohn Institute, 1997).



Had Connecticut indexed its taxable wage base after 1999, the current taxable wage base would be approximately \$21,800 (see chart below) and the state would have had to engage in much less federal borrowing.



Connecticut has committed to the federal solvency standard (1.0 AHCM),<sup>35</sup> but it has not increased the taxable wage base. As a result, Connecticut will rely on the existing fund solvency tax (an additional 0.1 to 1.4 percent imposed on all employers) to restore solvency for several years, in addition to higher FUTA taxes in the short term to pay off federal borrowing.

A sensible long-term solution is to spread the costs out more evenly by raising the taxable wage base to a level somewhere close to where it would have been had there been indexing over the past 15 years (\$21,800) and then indexing the wage base to future increases in the average weekly wage.

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<sup>35</sup> Public Act 12-46.