

The Challenge Facing the UI Financing System

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This working paper is part of the Unemployment and Recovery project, an Urban Institute initiative to assess unemployment's effect on individuals, families, and communities; gauge government policies' effectiveness; and recommend policy changes to boost job creation, improve workers' job prospects, and support out-of-work Americans.

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Unemployment Insurance (UI) is usually described as an experience-rated system in which cyclical increases in benefit payments are followed by a response of UI taxes that restores trust funds to pre-recession levels. The net stimulus provided during the downturn, when UI benefit payments exceed UI taxes, is reversed in the ensuing recovery, as UI tax revenues exceed benefit payouts. Is this an accurate characterization of the current situation? Enough time has elapsed since the onset of the Great Recession and the subsequent economic recovery that patterns of state UI behavioral responses can be discerned.

Our current UI financing system, operative for more than 75 years, places major responsibility for program financing on the individual states. The so-called regular UI program that pays up to 26 weeks of benefits in most states is financed almost totally by employer payroll taxes. States determine most statutory provisions related to benefit eligibility, payment levels, and duration as well as program financing. The states are subject to certain federal requirements, mainly in four areas:

1. Each state must have an acceptable system for experience rating employer UI taxes.
2. The state taxable wage base must be at least \$7,000 per worker.
3. The maximum employer tax rate must be at least 5.4 percent of taxable payroll.
4. States must make prompt and accurate determinations of applications for and payments of UI benefits.

The Great Recession caused huge increases in UI claims and challenged the state UI administrative apparatus in several ways. Payment promptness and payment accuracy both declined during 2009 and 2010, and only now are performance measures returning to pre-recession levels.

The recession caused sharp decreases in UI trust fund balances and widespread borrowing from the U.S. Treasury to finance regular UI benefit payments.¹ Since 2008,

¹ The Great Recession also was accompanied by an unprecedented increase in benefit payments to the long-term unemployed who had exhausted regular UI benefits. However, financing for long-term benefits (Emergency Unemployment Compensation and Federal-State Extended Benefits) has been fully discharged by the federal partner.

35 of the 51 state systems (the 50 states plus the District of Columbia) borrowed from the U.S. Treasury and loans totaled more than \$50 billion.² At the end of March 2012, 28 states had outstanding Treasury loans that totaled about \$40 billion. Additionally, three states have borrowed in the private securities market and owe roughly a combined \$5 billion. Because interest rates in private markets are lower than the rates on Treasury loans, other states are likely to pursue this option during 2012.³ UI trust funds remain severely depleted in most states.

States with debts to the Treasury in 2011 and later years are paying interest on their loan balances. The annual interest rate was 4.09 percent in 2011 and is 2.94 percent in 2012. Additionally, debts outstanding for more than two years are subject to mandatory repayments through increases in UI taxes levied by the federal partner. During 2011, 23 states paid higher federal UI taxes. The higher taxes start at 0.3 percent of federal UI taxable wages in the first year, but then grow each year loan balances remain unpaid. To avoid these borrowing costs, states have strong incentives to repay their Treasury loans.

How Have the States Responded?

As might be expected in a financing system with more than 50 jurisdictions, the states have responded in a variety of ways to the Great Recession and its attendant financing challenges. Table 1 presents selected information describing the pre-recession situation and one key aspect of the state responses, increasing the taxable wage base. The table emphasizes four things: the pre-recession situation, tax base indexation, state size, and changes in the UI tax base. Because of the large number of states and associated details, table 1 shows summaries of state-level data that permit comparisons by indexation status, state size, trust fund reserves, and changes in the UI taxable wage base between 2007 and 2012. The underlying data for each state are available from required state reports submitted to the Office of Unemployment Insurance of the U.S. Department of Labor.

All entries in table 1 are either state-level averages or counts of states in the groups identified by columns (1)–(3). Column (1) identifies the number of states covered by a specific summary measure. Columns (3), (5), and (7) show counts of states included in the grouping identified in column (1). Columns (4), (6), (8), and (9) show simple averages for the states included in the indicated groupings. In panels C and D, the states have been ranked according to five size groupings that respectively show contrasts by state size (panel C) and by the change in the UI taxable wage base between 2007 and 2012 (panel D).

² The UI programs in Puerto Rico and the Virgin Islands are not included in this narrative. The Virgin Islands' program has also borrowed from the Treasury.

³ Illinois has already authorized loans of \$2.4 billion and Colorado and Pennsylvania are considering this option.

Table 1. State UI Financing and the Great Recession

Number of States	State Rankings	Indexed States	Employment, 2009 (000s)	13 Biggest States	RRM 12/31/2007	Loans 2008–2012	Reserve Ratio 12/31/2010	Tax Base Increase 2012/2007
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A. All 51 States								
Avg.—51 States		16	1,955	13	0.54	35	-0.17	1.20
Panel B. States by Indexation Status								
16 Indexed		16	1,130	2	0.83	6	0.47	1.19
35 Not Indexed		0	2,333	11	0.41	29	-0.47	1.20
Panel C. States Ranked by Size (Employment in 2010)								
10	1–10	2	5,259	10	0.24	10	-1.09	1.06
10	11–20	2	2,227	3	0.32	9	-0.62	1.15
11	21–31	3	1,374	0	0.61	7	0.00	1.16
10	32–41	5	677	0	0.83	5	0.14	1.32
10	42–51	4	299	0	0.68	4	0.69	1.30
Panel D. States Ranked by Tax Base Increases between 2007 and 2012								
10	1–10	2	761	0	0.57	6	-0.23	1.59
10	11–20	5	1,534	1	0.71	5	0.33	1.22
11	21–31	7	1,824	3	0.44	7	-0.11	1.15
10	32–41	2	2,798	7	0.42	10	-0.92	1.03
10	42–51	0	2,872	2	0.55	7	0.06	1.00

Source: Data assembled at the Urban Institute based on state reports submitted to the Office of Unemployment Insurance of the U.S. Department of Labor.

The states vary widely in size, with employment in 2009 ranging from 11.5 million in California to 204,000 in Vermont. Average state employment in 2009 was 1.955 million. The differences in state size mean that a small group of states has a disproportionate weighting in determining the aggregate performance of the UI system. In 2009, for example, employment in the 13 largest states was 60.6 million, or 61 percent of the 99.7 million national total.

Size is important because state behavior differs according to state size. To a first approximation, the smaller states behave much more like the earlier description of UI program financing. Small states maintain proportionately larger reserves, and their tax systems are more responsive to trust fund drawdowns vis-à-vis the larger states. A second

important aspect of interstate variation is indexation of the taxable wage base. Between 1999 and 2011, 16 UI programs operated consistently with an indexed taxable wage base. Panel B shows the contrast between these 16 and the other 35 where the tax base changes only through state legislation.

Note in column (4) of panel B that the states with indexed UI programs are much smaller than the nonindexed states, on average about half the size of the other 35 states. Thus they represent 31 percent of the 51 state programs but only 18 percent of covered employment. New Jersey and North Carolina are the only two of the 13 largest states with indexed tax bases.

On average, the indexed states entered the Great Recession with much larger reserves than the other states. The most common measure of trust fund adequacy is termed the reserve ratio multiple (or RRM).⁴ States with higher RRMs are judged to have more solvent UI trust funds. Whereas the simple average of all RRMs at the end of 2007 was 0.54 (implying roughly 6.5 months of reserves in the trust funds, measured at the highest-ever previous annual payout rate), the average RRM for the indexed states stood at 0.83, or twice the average of 0.41 for the nonindexed states. Largely due to their higher pre-recession reserves, only six of the 16 indexed states (or 38 percent) borrowed during the Great Recession compared to 29 of 35 (or 83 percent) nonindexed programs. Finally, note in panel B that the average reserve ratio (reserves as a percent of payroll) at the end of 2010 for the indexed states was 0.47 compared to -0.47 for the nonindexed states. With higher pre-recession reserve balances, the indexed states have experienced proportionately fewer financing problems compared to the other 35 states.⁵

Panel C emphasizes state size and shows strong contrasts by size. Whereas the pre-recession RRM averaged 0.54 across all 51 states, it averaged just 0.24 for the 10 largest states and 0.32 for the next 10. With such low reserves it may not be surprising that all 10 of the largest states secured loans from the Treasury between 2008 and 2012. In the second-largest grouping (states ranked 11 to 20), low pre-recession reserves and widespread borrowing (9 of 10) also occurred. For the three smaller size groupings, pre-recession reserves were generally much larger and borrowing was comparatively less

⁴ The RRM is a ratio of two ratios. The numerator ratio, termed the reserve ratio, is the ratio of trust fund reserves to annual covered payroll and is expressed as a percentage. The denominator ratio is the highest past 12-month payout rate, benefit payments as percent of covered payroll, also expressed as a percentage. A recommended standard of trust fund adequacy is to have a pre-recession RRM of 1.0, indicating 12 months of reserves in the trust fund. In practice, most states have operated with RRMs substantially below 1.0.

⁵ Readers are reminded that the text emphasizes averages for groupings of states. For the six indexed states that have borrowed from the Treasury (Hawaii, Idaho, Minnesota, Nevada, New Jersey, and North Carolina) their financing problems have generally been less serious relative to the 29 nonindexed states that have borrowed.

frequent (16 of 31 states). At the end of 2010, the average reserve ratio percentage for the largest 10 averaged -1.09 compared to 0.69 for the smallest 10.

Since the largest states entered the recession with the smallest average RRM, it might be expected that their tax systems would respond more strongly during 2009–2012 than the systems in other states. Panel D explores one aspect of the tax response, changes in the tax base between 2007 and 2012. Overall, column (9) shows that tax bases in UI programs were about 20 percent higher in 2012 than in 2007. Panel B shows that the proportional increases were similar in indexed and nonindexed states. However, the levels of the tax bases in the two groups of states are sharply different. The simple average in the indexed states in 2007 was \$24,275 compared to \$9,014 in the nonindexed states, for a ratio of 2.69. In 2012, the two averages are \$28,700 and \$10,682, also a ratio of 2.69. The relative tax base positions for the two groups in 2012 were unchanged from 2007.

Panel C in table 1 shows that the largest states as a group had the smallest proportionate tax base increases between 2007 and 2012. Their average 2012/2007 ratio in column (9) was only 1.06 compared to ratios of 1.32 and 1.30 for the two smallest groups of states.

Panel D shows that several states enacted substantial increases in their tax bases between 2007 and 2012. The average 2012/2007 ratio for the 10 with the largest increases was 1.59 compared to 1.00 (no change) for the 10 with the smallest increases. The largest proportional increases occurred in Mississippi and Vermont where the tax base in 2012 was double the tax base in 2007. Increases of 50 percent or more also occurred in New Hampshire, South Carolina, and West Virginia. At the opposite extreme, 16 states made no change in their taxable wage bases between 2007 and 2012. Those making small or no changes were disproportionately the largest states. Eight of the 13 largest states made no changes and two (Florida and Michigan) increased their tax bases by just \$1,000 and \$500 respectively. Columns (4) and (9) in panels C and D show vividly that large tax base increases occurred in small states, while large states made no changes or only small changes.

A major inference to be drawn from table 1 is that many of the states that needed to make large changes to improve solvency after the Great Recession have done little or nothing to date to raise their taxable wage base.

The second dimension that affects UI tax revenue is the average tax rate levied on taxable wages. Changes in average tax rates alone can dramatically improve solvency. For example, Maryland is one of the 16 states that did not change its taxable wage base between 2007 and 2012. However, tax revenue increased sharply in 2010 and 2011 through an increase in the effective tax rate on taxable payroll. The tax rates on taxable wages for the four years 2008 to 2011 were 1.70, 2.03, 4.54, and 5.08 percent respectively. This aggressive increase in the tax rate enabled the state to repay its Treasury loans

and build its trust fund balance from less than \$150 million at the end of 2009 to more than \$400 million two years later.

While Maryland's tax rate response was dramatic, several other states have altered their tax rates and tax bases in ways that prevented the accumulation of large-scale trust fund debts during 2009, 2010, and 2011. Examples are provided by New Hampshire, South Dakota, Tennessee, Vermont, and West Virginia. Note that four of these six activist states are small.

Unlike the taxable wage base, for which 2012 statistics are already available, UI tax rates and total tax revenue are only available through 2011. Table 2 summarizes data on benefit payouts and tax revenue during 2009, 2010, and 2011 for the nation and for selected groups of states. States have been combined into groups of five according to size, indexation status, borrowing status, and activist policy responses. At the national level, UI benefits and taxes were nearly equal in 2007, \$30.3 and \$31.5 billion respectively. All entries for the five-state groupings in table 2 are based on sums of the underlying state data, with each of the three later years measured as a ratio to 2007. Thus, for the five biggest states, the ratio of 2009 benefits to 2007 benefits was 2.43 and the tax ratio was 0.86.

Table 2. UI Tax Responses during 2009–2011 Based on National and State Data

	U.S.—51 States		5 Biggest States ^a		5 Next Largest States ^b	
Ratio to 2007	Benefits	Taxes	Benefits	Taxes	Benefits	Taxes
2009	2.47	0.89	2.43	0.86	2.37	0.87
2010	1.82	1.13	1.83	1.11	1.51	1.03
2011	1.47	1.41	1.57	1.40	1.36	1.27
	5 Indexed States with No Loans ^c		5 Indexed States with Loans ^d		5 Activist States ^e	
Ratio to 2007	Benefits	Taxes	Benefits	Taxes	Benefits	Taxes
2009	3.37	0.78	2.47	0.91	2.52	1.36
2010	2.39	1.13	1.80	1.07	1.82	1.99
2011	1.87	1.45	1.57	1.30	1.63	2.29

Source: Data assembled at the Urban Institute based on state reports submitted to the Office of Unemployment Insurance of the U.S. Department of Labor.

a. California, Texas, New York, Florida, and Illinois

b. Georgia, Michigan, Ohio, Pennsylvania, and Virginia

c. Iowa, Oklahoma, Oregon, Utah, and Washington

d. Idaho, Minnesota, Nevada, New Jersey, and North Carolina

e. Maryland, New Hampshire, South Dakota, Tennessee, and West Virginia.

In several ways table 2 reproduces patterns described earlier in table 1 but with details on benefits as well as taxes. All 2009/2007 benefit ratios were 2.37 or larger. As the Great Recession was experienced by all states, note also how regular UI benefit payouts decreased substantially after 2009. The ratios in 2011 fell into the 1.36–1.57 range with the exception of the five indexed states with no loans (a 2011/2007 ratio of 1.87).

Table 2 shows that benefit payouts in the largest and the next-largest states grew slightly below national average growth. Since their pre-recession RRM's were noticeably below average (recall column (6) of table 1), one might have expected their taxes would increase by more than the national average during 2010 and 2011. However, their tax growth ratios in table 2 were below the national average in both years. As noted earlier, nearly all the big states (19 of the top 20 in 2009 employment) have borrowed from the Treasury.

Table 2 also summarizes revenue growth for two groups of states with indexed tax bases. Perhaps surprisingly, the group of five that have borrowed from the Treasury had lower revenue growth than the five that have not borrowed (2011/2007 revenue ratios of 1.30 and 1.45 respectively). As with the two groups of big states, securing Treasury loans has not yet provoked an above-average growth in revenue in the indexed states needing loans.

The revenue response of the five activist states stands in clear contrast to the other groups included in table 2. Their 2010/2007 revenue ratio was 1.99 compared to ratios between 1.07 and 1.13 in the other quintets of states. Their average 2011/2007 ratio of 2.29 is by far the highest tax revenue growth ratio in table 2. This group even exhibited a revenue response in 2009 while all other 2009/2007 tax ratios were below 1.0. Because of their strong policy responses, all five activist states now have positive trust fund balances averaging about half of their 2007 balances.

Revenues in the biggest states responded sluggishly during 2010 and 2011 against a background of high corporate profits, the highest of the past 65 years as a share of GDP (profit shares of 0.124 and 0.128 respectively compared to a 1989–2011 average of 0.095).⁶ Regular UI benefits were reduced in four of the large states (Florida, Illinois, Michigan, and Pennsylvania) during the 2011 legislative sessions and in Georgia in 2012. The benefit reductions will help lessen future trust fund outflows but one can question the timing, as unemployment rates have remained high in these states. The unemployment rates in these states in early 2012 equal or exceed 7.9 percent and unemployment durations remain at unprecedented levels.

⁶ Between 1947 and 2011 profits as a share of GDP reached 0.120 only six times. The six years and associated shares were as follows: 1950—0.121, 1951—0.120, 1965—0.120, 2006—0.120, 2010—0.124 and 2011—0.129. To the extent that profits influence ability to pay, U.S. businesses have been in an unusually strong position during 2010 and 2011 and again in 2012.

The data summarized in tables 1 and 2 provide useful information for assessing the response of the current UI system to the Great Recession. Total revenue of the state UI system in 2011 roughly matched total regular UI benefit payments (\$44.4 and \$43.0 billion respectively). The indebtedness of the system at the end of 2011, about \$42 billion, nearly equaled annual UI tax revenue of 2011. Revenues will have to exceed benefits for several years to achieve a positive net balance and still more years to build robust fund balances. A recession later in this decade would only add to the trust fund deficits and financing problems of the current system.

The Great Recession has exposed serious weaknesses in the current method of financing regular UI benefits. State UI revenues have been slow to respond to trust fund deficits and the response has been most sluggish in the largest states, where the financing problems are most acute. Annex A gives short descriptions of the policy responses in the 13 largest states.

To summarize the findings of Annex A, five factors have combined to yield a sluggish revenue response for the 13 largest states:

1. Two states were already on their highest tax rate schedule at the start of the Great Recession (California and North Carolina).
2. Five have enacted legislation or have implemented administrative measures that reduced the revenue growth that would have occurred automatically under the state's experience-rating statute (Florida, Massachusetts, Michigan, New Jersey, and Ohio).
3. Six have emphasized benefit reductions to defer or reduce the level of future UI taxes (Florida, Georgia, Illinois, Michigan, Pennsylvania, and Texas).
4. Although five did institute higher taxable wage bases, the increases were either automatic due to indexation (New Jersey and North Carolina) or small (Florida, Illinois, and Michigan).
5. Three have already committed to borrowing in the private bond market (Illinois, Michigan, and Texas). The issuance of private debt instruments will reduce loans owed the Treasury but will not per se improve long run trust fund balances.

Thus the small aggregate response of revenues for the 13 largest states reflects the combined effects of several factors with a single primary motivation: to reduce the near term increase in UI taxes paid by employers. The most obvious consequence of these actions is to delay the restoration of large, positive UI trust fund balances in the largest state UI programs.

Given the present situation one might ask: Is the present UI financing system with its heavy reliance on state-level decisions still a viable system? Should a major restructur-

ing of the system be considered? Are there foreign approaches or lessons from foreign experiences that merit serious consideration in the United States? The next few pages address the last question.

Foreign Experiences Financing Unemployment Insurance

Unemployment compensation systems are part of the social safety net in nearly all advanced economies. Twenty-seven of the 30 economies with the highest per capita GDP in 2008 had a program to compensate those involuntarily unemployed.⁷ The unemployment compensation (UC) systems in many economies have two components: (1) unemployment insurance (UI)—a system that usually pays benefits linked to past earnings to persons regardless of income, and (2) unemployment assistance (UA)—a system that pays benefits to the unemployed who either do not qualify for UI or have exhausted their UI entitlements. While UI programs usually pay benefits to eligible persons regardless of other income sources, UA programs are typically reserved for those among the unemployed with incomes below a designated threshold.⁸

Annex B briefly reviews important benefit and tax features of 22 UC programs in the United States plus 21 foreign countries to identify features common to most or all programs as well as unique features of the U.S. system, and to discuss foreign features that might be usefully adopted by the United States. Certain features of our UI system are rare or unique when viewed from a comparative context:

1. The first noteworthy feature of UI in the United States is the importance of subnational, i.e., state, laws governing benefits and taxes. The other 21 countries reviewed in Annex B all operate unitary systems governed by a national statute. Several aspects of taxes and benefits are determined by state UI laws in the United States. While the originating legislation is a national law (the Social Security Act of 1935), state and national governments are full legislative partners in the U.S. system. Most laws and administrative practices are controlled by the states.
2. The United States is also unique in relying upon experience rating to set UI payroll tax rates for employers. While the states exhibit wide diversity in their experience-rating provisions, all adhere to the principle that employers with higher benefit charges

⁷ The statement refers to economies with total populations of at least 1.0 million persons. The three exceptional economies are Kuwait, Singapore, and the United Arab Emirates.

⁸ Both UI and UA have unemployed persons (mostly job losers) as their primary clients. Additionally the unemployed may receive cash and/or in-kind payments from other programs where the primary clients come from the low-income segment of the population. In the United States this includes TANF (social assistance or welfare), SNAP (formerly Food Stamps), and the earned income tax credit (EITC).

pay higher UI taxes vis-à-vis employers with lower charges. No other nation's UI system among the 22 examined in Annex B uses experience rating to set employer tax rates.

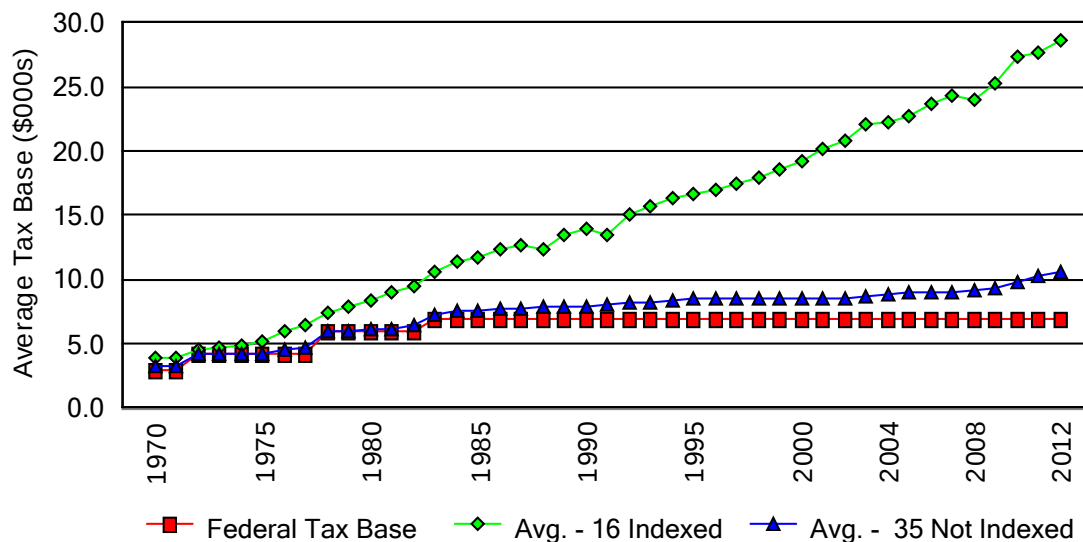
3. Most countries levy UI taxes on the majority of wages paid by covered employers. For 19 of the 20 countries in Annex B that use payroll taxes to finance their programs, the tax base is sufficiently high that 70 percent or more of covered wages are taxed. Because the majority of U.S. states set their UI tax base at a level close to the minimum federally required tax base (currently \$7,000 per year per worker), taxable wages as a proportion of total covered wages are much lower than in all the other countries. The U.S. average during 2001–2010 was only 0.28. Its uniquely low UI tax base helps explain why the United States is the only country examined in Annex B where UI payroll taxes average less than 1.0 percent of covered payroll. The 2001–2010 average was 0.68 percent.
4. Most countries levy UI payroll taxes on workers as well as employers, i.e., 18 of the 20 countries with UI payroll taxes in Annex B. Italy is the only other country besides the U.S. that does not levy a payroll tax on covered employees.⁹
5. Except for its low entry eligibility requirement, statutory benefit provisions examined in Annex B suggest the U.S. system is modest in scope and benefit costs. The maximum duration of regular UI of 26 weeks falls below the maximum of nearly all other UC systems and its cost rate of 0.607 percent is the lowest except for Japan, Korea, and the United Kingdom.
6. The unique features of the U.S. system are found mainly in its financing arrangements. Are there features of the foreign UI systems that merit adoption in the U.S.? To this author two things stand out: (1) the absence of an employee UI payroll tax and (2) the low taxable wage base in the majority of state programs. Changes in either or both of these features could permanently enhance UI revenues and improve long-run solvency prospects.
7. The evidence on the importance of having a high taxable wage base is clear. The states with indexation have maintained consistently higher tax bases, and, more important, higher reserve balances than the other states. During the Great Recession they were half as likely to borrow compared to the nonindexed states and the average size of their loans was smaller.

⁹ A small exception in the United States is the employee UI payroll taxes in Alaska, New Jersey, and Pennsylvania.

8. States with indexation do not have to enact new legislation to raise the tax base. In 1984, a year after the present federal tax base of \$7,000 was instituted, the average tax base in the 16 indexed states was \$11,416 compared to \$7,551 in the 35 nonindexed states.¹⁰ This year, while the federal tax base remains at \$7,000, the corresponding averages are \$28,700 and \$10,682 respectively. The highest of the nonindexed tax bases this year are \$16,000 in Vermont, \$15,000 in Connecticut, and \$14,000 in Massachusetts and Mississippi.

Chart 1 traces developments in the average tax base for the two groups of states. Note how closely the average tax base for the nonindexed states follows the federal taxable wage base. Even in 2012, a full 29 years after the \$7,000 federal tax base was established, the nonindexed average is less than \$4,000 above the federal tax base. Second, note the steady growth in the average tax base for the indexed states. This growth has meant that the taxable wage proportion (taxable wages as a ratio to total covered wages, or TWP) has changed relatively little since 1970. The average has been between 0.50 and 0.55 during all 43 years spanned by chart 1. For the other 35 states the average TWP decreased from 0.51 in 1970 to 0.31 in 2010. Absent indexation, the states have been reluctant to increase their tax bases much above the floor provided by the federal taxable wage base.

Chart 1. State UI Tax Bases, 1970 to 2012



¹⁰ All state-level averages in the present discussion are simple averages, not averages that weight states by size.

The laggard performance of the taxable wage base in the United States stands in contrast to that of 19 other countries examined in Annex B. Chart 1 suggests a simple mechanism for raising the tax bases in the states: raise the federal taxable wage base. What would be a reasonable target for such an increase? Historic data from state UI programs and from the Social Security OASDI (Old-Age, Survivors, and Disability Insurance) program provide helpful information on this point.

The UI programs in Hawaii and Idaho have indexation percentages of 100 percent of lagged statewide annual wages. Both states have a TWP of about 70 percent of total wages. Oregon and Washington index their bases at 80 percent of statewide annual wages and have TWPs of about 0.60. This year OASDI has an indexed tax base of \$110,100. This high tax base, about 2.5 times annual wages, draws revenue from about 85 percent of OASDI-covered wages. It seems that increasing the UI tax base from 100 to 250 percent of average annual wages would only increase TWP by about 0.15 (or from about 0.70 to 0.85). Simulations with micro UI earnings data from Ohio support this inference.

Federal UI legislation proposed during 2011 included a provision to increase the federal UI taxable wage base to \$15,000 in 2014. This would affect nearly all nonindexed states, but the increase in TWP nationwide would be modest, roughly from 0.15 to 0.29 in 2014. If the federal base is increased (and indexed at the same time), there is an argument for a much larger increase. Operating UI with higher tax bases would shift some of the financing burden to employers that pay higher wages from low-wage employers and their workforces.¹¹

A second avenue for increasing UI tax revenue would be to tax covered employees. As noted above, 18 of the 20 countries with UI payroll taxes already tax employees. Since the average employed worker enjoys a better financial situation than the typical unemployed worker, this can be advocated as a way to infuse new monies into UI revenue streams. The tax base for employee payroll taxes would not necessarily have to be the same as the base for employer payroll taxes. Pennsylvania currently taxes UI employers on the first \$8,000 of annual wages while at the same time it taxes employees on total annual wages.

¹¹ Although UI taxes are experience-rated, the link between higher benefit payouts and higher future UI taxes is imperfect. With effective experience rating accounting for 50-60 percent of total UI taxes, the remaining 40-50 percent is usually levied at a single flat rate on taxable payroll and falls more heavily on low-wage employers. The lower the UI tax base, the larger share of the tax burden on low wage employers their workers.

Raising the taxable wage base and taxing employees could be easily implemented as all states already have the UI tax collection apparatus in place. Both changes could increase the long-run flow of UI revenues and enhance future state trust fund balances.

One other idea suggested by international practices is to establish an unemployment assistance (UA) program. This would pay benefits to eligible UI exhaustees. Since UA would focus on the unemployed, it could have work-search requirements (i.e., able, available, and actively seeking work) similar to UI requirements. It could also condition eligibility on low income, thus targeting a subset of the long-term unemployed. Administration of UA could be conducted within the existing UI/ employment service/One Stop system that already deals with questions of continuing eligibility among UI recipients.

The United States currently lacks a second-tier program of UA that focuses on the long-term unemployed. Other income support programs such as SNAP, TANF, and the EITC have an antipoverty focus and serve a more diverse client base than the unemployed clients served by a UI-UA system. The need for programs that focus on the unemployed to hasten reemployment is becoming more important as the frequency of temporary layoffs decreases, employer reliance on permanent job separations increases, and the duration of unemployment spells lengthens. A functioning UA program to backstop UI would have advantages over SNAP, TANF, and the EITC in focusing its services on clients attached to the labor market and seeking work.

A careful discussion of second-tier (or long-term) unemployment benefits is important, but it lies outside the scope of the present paper's concern with UI financing problems. The United States has extensive experiences with both permanent and temporary UI extended benefit programs, e.g., Federal-State Extended Benefits (EB) and Emergency Unemployment Compensation (EUC), but they concentrate mainly upon income support, not reemployment.

The Employment Act of 1946 and the Humphrey-Hawkins Act of 1978 acknowledge the federal government's responsibility for maintaining full employment and for restoring full employment when the economy experiences a recession. Thus full federal financing of emergency UI programs like the present EUC program is appropriate. Full federal financing of the Federal-State EB program as structured under the American Recovery and Reinvestment Act (ARRA) and subsequent extensions has also been appropriate. With the temporary full federal assumption of EB costs under ARRA, 26 states adopted temporary total unemployment rate triggers and paid EB during most of 2009, 2010, and 2011. Given the severity of the downturn, the large total payout of EUC and EB benefits has been appropriate to the scale of the unemployment problem. As the economic recovery proceeds and unemployment decreases, many states will automatically

trigger off EUC and EB well before the latest extensions expire at the end of 2012. Between the weeks of April 1 and May 13, 2012, for example, the number of states with active EB intake decreased from 31 to seven.

Financing extended benefit programs has been exclusively a federal responsibility during the Great Recession and has not generated much discussion. The next section will focus on the states' problems financing the regular UI program.

Possible Policy Directions for UI Financing

What should be done to improve regular UI program financing and prevent a recurrence of the large-scale borrowing of the last five years? Given the size of state debts in 2012, widespread state indebtedness will persist for several more years. At the same time, it must be recognized that many state programs navigated the Great Recession without borrowing or with needing only small loans that were quickly repaid. Because the situations of the individual states are so diverse, appropriate policy recommendations need to be sensitive to this diversity. Any policy that offers debt forgiveness has to involve a quid pro quo from debtor states that will substantially improve their future solvency. To avoid an adverse behavioral response among nondebtor states, some recognition and reward for their actions (both past actions that yielded large pre-recession reserves and tax and revenue adjustments made after the onset of the recession) should also be part of a comprehensive package.

The following paragraphs describe two distinct approaches for achieving debt reductions in the short run and improved trust fund solvency in long run: (1) changes within the present federal-state framework and (2) changes that expand the federal role in UI financing. Because incremental change within the present financing framework seems the more likely of the two, most of the discussion will address the first approach.

To reduce the volume of state indebtedness and restore the solvency of state programs, several policy actions could be taken by the state and federal partners. The federal partner can institute actions that provide financial incentives for states to undertake solvency-enhancing actions. One obvious restorative action by states is to allow experience rating to operate as stipulated in state statutes. During 2011 and 2012 at least seven large debtor states enacted laws to reduce UI taxes.¹² The tax reductions have occurred despite the unprecedented profits realized by employers during both years.¹³ As a first step to hasten the pace of trust fund restoration, these actions should be reversed. A second constructive state

¹² This includes Florida, Massachusetts, Michigan, New Jersey, Ohio, Pennsylvania, and Texas.

¹³ The profits share of GDP was 0.124 in 2010 and 0.129 in 2011. These are the two highest profit shares for the entire period from 1947 to the present. The share in the first three months of 2012 was 0.128.

action would be to raise the taxable wage base. As noted previously, several states are operating with higher tax bases in 2012 than in 2007. Among the 13 largest states, all with trust fund loans since 2008, eight have the same tax base as in 2007 while the largest percentage increase among the other five is just 17.9 percent in Illinois. Except for New Jersey and North Carolina which have indexed tax bases, the highest tax base among the other 11 is \$14,000 in Massachusetts. In fact, nine of the 11 biggest nonindexed states have a tax base below \$10,000 in 2012. Reluctance to increase the tax base has been widespread even in the face of borrowing and large UI trust fund debts.

All regular state UI programs operated with a maximum duration of at least 26 weeks every year between 1970 and 2010. During 2011, however, six states reduced the maximum duration of regular UI benefits below 26 weeks.¹⁴ These and other recent benefit reductions will have long-term effects in reducing regular UI benefits and the stabilizing effect of UI.

Restoring Solvency within the Present Financing System

The standard description of UI program financing given at the start of this paper emphasizes the role of experience rating in raising UI taxes and restoring trust fund balances following recessions. Will debtor states restore their trust funds through their own efforts? Based on actions taken in 2010, 2011, and early 2012, it appears the answer may be no. Most debtor states have not yet acted decisively to reduce their debts, and debt repayment is proceeding slowly. Aggregate net reserves on May 31, 2012, the monthly seasonal peak, were -\$16.9 billion, an improvement of just \$8.2 billion over May 2011. At the current pace, it may take three more years just to bring net reserves to zero, much less to build substantial positive balances.

The variety of ways debtor states are financing the interest charges on their Treasury loans provide insight into current state decisionmaking. During past recessions these charges were typically financed with a special assessment added to employers' state UI tax obligations. For 10 debtor states with interest obligations in 2011, some other source was accessed to relieve employers from paying these interest charges.¹⁵ Even though contributions were inadequate prior to the Great Recession, employers were relieved of interest charges caused in part by inadequate pre-recession reserves. If this is the way interest charges are being addressed in several states, imagine the difficulty in getting the states to raise UI taxes to restore their trust fund balances.

¹⁴ South Carolina increased its maximum duration to 26 weeks from 22 weeks in 1970. The six states with a maximum duration below 26 weeks in 2012 are Arkansas, Florida, Illinois, Michigan, Missouri, and South Carolina. Georgia reduced its maximum duration below 26 weeks during its 2012 legislative session.

¹⁵ Delaware, Georgia, Illinois, Kansas, Kentucky, North Carolina, Nevada, Ohio, Virginia, and Vermont.

The federal partner may have to provide incentives for debtor states to do the right thing, i.e., raise tax revenue substantially and not reduce regular UI benefits. Proposed federal actions to encourage improved solvency were part of federal legislation introduced but not enacted during 2011. Senators Durbin, Reed, and Brown sponsored the Unemployment Insurance Solvency Act of 2011 (Senate bill S.386.IS) with two features designed to improve UI trust fund solvency. First, it provided financial rewards to states that increased revenues by enough to fully repay their trust fund loans and build a large reserve within seven years. Second, it proposed to increase the base for the federal UI tax from its current \$7,000 per covered worker per year to \$15,000 in 2014. Later in the 2011 legislative session, the Obama administration's budget proposal for fiscal year 2012 included both proposed changes. While neither change was enacted during 2011, their enactment could help solvency in the debtor states. A few comments about these two proposed solvency enhancements are warranted.

For states that improved solvency over the following seven years, the Durbin, Reed, and Brown bill would forgive part of their UI trust fund debts in seven equal annual installments. To be deemed acceptable, a debtor state's principal abatement (debt repayment) plan must maintain the benefit provisions of its current UI law.¹⁶ This requirement means that the improvement in long-run solvency would come from increased UI taxes. Each state determines the form of the tax increases, but one element must be an increase in the taxable wage base. This must increase to at least \$15,000 by 2014, and subsequent increases are to be tied to the growth in average wages nationwide. Acceptable principal abatement plans must improve solvency sufficiently to reach an RRM of at least 1.0 by the end of the seven years. The federal partner determines if the state's plan is acceptable or not. For states that enact acceptable plans, the principal on their outstanding loan balances would be reduced proportionately by 0.2, 0.4, or 0.6, with the proportion depending on the increase in the state's unemployment rate between 2007 and 2009.¹⁷ Larger financial rewards would go to states with bigger increases in unemployment. Annual principal abatements would be spread evenly over the seven years.

Given the large scale of debts in several states, it should be noted that the required tax increases are substantial. Pennsylvania, for example, had a debt of \$3.235 billion at the end of 2011, or 1.70 percent of payroll. The historic high cost rate for Pennsylvania is

¹⁶ This is specified to mean four things: (1) no change in the calculation of the weekly benefit amount that would reduce it, (2) no restriction on UI eligibility, (3) no reduction in the maximum weekly benefit, and (4) no other change that effectively reduces UI benefits relative to current law.

¹⁷ Increases of 1.5 to 2.5 percentage points would reduce the loan principal by 0.2. Increases between 2.5 and 3.5 percentage points would reduce it by 0.4 and increases above 3.5 percentage points would reduce it by 0.6.

3.37 percent, the payout rate during the 12 months of 1982.¹⁸ If the state enacted a solvency package during 2012 that would achieve an RRM of 1.0 after seven years, net reserves would have to be \$8.6 billion at the end of 2019. This would represent an increase in the trust fund of \$11.8 billion from its negative balance at the end of 2011. If regular UI benefit payouts between 2012 and 2019 average \$3.0 billion per year, UI taxes between 2012 and 2019 would have to total \$35.8 billion to cover benefit costs while raising the fund balance to \$8.6 billion at the end of 2019.¹⁹

Pennsylvania employers paid about \$2.8 billion in regular UI taxes or 1.47 percent of covered payroll in 2011. To generate \$35.8 billion in revenue between 2012 and 2019, the average tax rate would need to be 1.96 percent of payroll.²⁰ Achieving this amount of revenue during 2012–2019 would represent an increase in the effective tax rate of 33 percent above the tax rate in 2011. Given the size of the current debt, the needed increase in tax revenue is very large. The burden could be lessened if the repayment period were stretched to, say, 10 years, but that would imply a slower approach to fund adequacy. If there were a recession sometime between 2012 and 2019, that would add to the state’s trust fund financing problem.

The increase in unemployment rate in Pennsylvania between 2007 and 2009 exceeded 3.5 percentage points. Assuming the state reached the \$8.6 billion target and assuming that 60 percent of its debt were forgiven, this would reduce the loan principal from \$3.235 billion to \$1.294 billion. Partial loan forgiveness would reduce the 2012–2019 revenue requirement from \$35.8 to \$33.9 billion and the effective tax rate from 1.96 to 1.85 percent. Partial debt forgiveness has only a small effect in reducing the volume of the future taxes needed to achieve fund solvency by the end of 2019. Even with partial forgiveness the effective rate would need to average about 1.85 percent of payroll over the eight years. If states opt for smaller tax increases, the trust fund would take longer to recover and for many states the prospect would not prevent several more years of net indebtedness, much less build a large positive trust fund balance. Other calculations point to a similar conclusion about the role of partial debt forgiveness in limiting the increase in UI taxes required to reach an RRM of 1.0. If annual benefit payouts in Pennsylvania averaged \$2.0 billion per year between 2012 and 2019, almost certainly an implausibly low estimate, total revenue needed to reach a fund balance of \$8.6 billion in 2019 would be \$27.8 billion. This revenue could be achieved with an average effective rate of 1.52

¹⁸ For comparative purposes, Pennsylvania’s highest annual payout rate during the Great Recession was 2.53 percent during 2009.

¹⁹ Details of the calculations are available from the author.

²⁰ This calculation assumes covered payroll grows by 4 percent per year between 2012 and 2019.

percent. Forgiving 60 percent of the loan would reduce this eight-year average tax rate to 1.41 percent, roughly the tax rate during 2011.²¹

To ensure that nonborrowing states would also have stake in maintaining solvency under the Durbin, Reed, and Brown bill, they would receive higher interest yields on trust fund balances that exceed specified thresholds. This would be a financial reward for prudent trust fund management. The reward would be larger for states that maintained higher RRM's.

Because the federal financing proposals of 2011 raise the federal UI tax base from its current \$7,000 to \$15,000 in 2014, federal unemployment taxes would increase substantially unless the federal tax rate were also reduced from its current 0.6 percent of federal taxable wages. Both 2011 proposals would reduce the federal UI tax rate to make the change in the federal UI taxes roughly revenue neutral. Unfortunately, neither initiative moved forward after being introduced.

Increasing the federal UI tax base would have important implications for regular UI revenue in many states. Under current federal UI tax conformity requirements, state UI programs must maintain a tax base at least at the level of the federal tax base. In 2012, 32 of 35 nonindexed programs have tax bases below \$15,000. While this number will likely decrease somewhat due to solvency legislation, most states will need to increase their tax bases in 2014 to reach \$15,000. The effects of higher tax bases on UI tax revenue could be partially or totally offset by modification of tax rate schedules, effectively lowering the average rate on taxable wages. In many states, however, the increase in the federal tax base would also cause state UI tax revenue to increase. This would help restore trust fund balances (or at least lessen future erosion), not only in 2014 but also in later years, through indexation of the taxable wage base.

Raising the federal UI tax base to \$15,000 would offset much of the erosion in the taxable wage share that has occurred since the base was set at \$7,000 in 1983. The tax base of \$7,000 in 1983 was 0.400 of average annual covered wages (\$17,500), and the taxable wage share was 0.429. A tax base of \$15,000 in 2014 would be about 0.29 of average wages, and the associated taxable wage share would be about 0.31.

If the federal tax base is to be increased in 2014 and then indexed, why not make a larger initial change? The indexation percentage implied by a \$15,000 base (the ratio of the tax base to average earnings) is only 0.29. The lowest indexation percentage among

²¹ Other calculations point to a similar conclusion about the role of partial debt forgiveness in limiting the increase in UI taxes required to reach an RRM of 1.0. If annual benefit payouts in Pennsylvania averaged \$2.0 billion per year between 2012 and 2019, almost certainly an implausibly low estimate, total revenue needed to reach a fund balance of \$8.6 billion in 2019 would be \$27.8 billion. This revenue could be achieved with an average effective rate of 1.52 percent. Forgiving 60 percent of the loan would reduce this eight-year average tax rate to 1.41 percent, roughly the tax rate during 2011.

the 16 indexed programs in 2011 was 50 percent. Moving the federal tax base to 50 percent of average wages would yield a tax base of about \$26,000 in 2014. An increase to \$26,000 would certainly have a larger effect on tax revenue in several states.

Increasing the federal tax base would also affect the burden of UI taxes across employers. Estimates of experience rating in UI programs suggest that about 60 percent of benefit payments are charged back to the employers whose (current and former) employees receive UI benefits. The remaining benefits are paid through common or socialized charges that typically are levied at a single rate across all employers. With a higher tax base, more of the burden of common charges would be paid by high-wage employers and less by low-wage employers. This would improve equity in the distribution of the UI tax burden, reducing the burden on low wage employers and their workers.

Will the states be willing to increase taxes by enough to restore solvency in the foreseeable future? Given widespread reluctance of states to increase taxes, it seems plausible that states will not increase revenue sufficiently to restore fund balances to levels suggested by the RRM solvency standard. It also seems that the financial (debt relief) incentives offered by the Durbin, Reed, and Brown proposal may be too small to exert much influence on state behavior. If that is the case, does the current structure of regular UI program financing need to be changed?

A Larger Federal Role in UI Financing?

With several states exhibiting strong reluctance to increase UI taxes, is it time to remove from the states some or all responsibility for determining UI taxes? This could be done in a number of ways which would differ in the scope of taxing responsibility remaining with the states. At one extreme UI taxes could be completely taken over by the federal government. Decisions about the tax base, the minimum and maximum rates, and the method for setting rates for individual employers (experience rating) could all be discharged by the federal partner. A second approach would have the federal partner establish annual revenue targets for each state, but allow states to set the tax base, minimum and maximum rates, and degree of experience rating applied to individual employers. The two approaches would remove some or all taxation decisions from the states due to the unwillingness or inability of some states to set rates appropriate for the volume of regular UI program benefits.

Either approach sketched in the previous paragraph would radically alter UI financing. However, all foreign UC programs (with the exception of China's) operate with central government responsibility for program financing. The tax base can be unlimited or limited, and the average effective tax rate can be variable or fixed from one year to the next. No foreign UC system uses experience rating, but that should not prevent a form of experience rating from continuing to be used here.

A third approach would impose a temporary federal takeover of financing decisions in states with a history of UI funding problems. The problem states, in other words, would be placed in receivership for a finite period until their trust fund is restored to a level deemed prudent by the federal partner. One variant of this approach would be to deny Federal Unemployment Tax Act (FUTA) tax credit offsets to “problem” states. A denial would increase the FUTA tax rate from its current 0.6 percent of federal taxable wages (or higher when loans have been outstanding for more than two years) to 6.0 percent. Those states with a demonstrated record of prudent fiscal stewardship, in contrast, would continue to operate their UI tax systems as at present.

The most radical proposal, i.e., the first alternative, would entail a full federal takeover of UI financing. This would remove all taxation authority from the states regardless of past performance in maintaining their UI trust funds. Experience rating might or might not be retained in such a federal financing system. Opposition to this proposal would probably be stronger than to the other two approaches just outlined.

Is there a reason to consider any of these radical proposals? Radical proposed solutions will likely gain support as the duration of net negative trust fund reserves in the big states extends further into the future. Support is also likely to grow if the state systems continue the 2011 pattern of increasingly relying on benefit reductions to improve long run solvency. Serious discussion of these radical alternatives will likely commence only after legislators can observe more years of small state tax responses or a clear pattern of states relying increasingly on benefit reductions.

ANNEX A.

The Biggest States: 13 Short Stories

The sluggish responses of UI taxes following the Great Recession is largely due to the limited response among the 13 largest states (measured by taxable covered employment in 2010). The simple average RRM for this group at the end of December 2007 as the downturn commenced was 0.24. Their average RRM was less than half the simple average of 0.54 for all 51 states and an average of 0.64 for the other 38 states.²² The 13 biggest states employ varied experience-rating systems, e.g., seven use reserve ratios, four use benefit ratios, and two use both reserve ratios and benefit ratios to set employer tax rates.²³ Combined, they accounted for 61 percent of covered employment in 2010 and 65 percent of covered payroll. Their experiences and behavior largely determine the overall performance of the UI system.

The present discussion focuses upon annual UI tax revenue before, during, and after the Great Recession, i.e., from 2006 to 2011. Primary emphasis is placed on tax revenue growth after 2007. A short summary of policy actions is given for each of the 13 states. Because of the timing of the downturn, its effect on covered employment, and the lags in UI tax rate determinations, the responses as of 2010 and 2011 are emphasized. Following the short summaries for each of the 13 states is a discussion that contrasts their revenue patterns with those of the other states in the UI system. Throughout, reliance is placed on table A1, which shows annual tax revenue between 2006 and 2011, and 2010/2007 and 2011/2007 revenue ratios.

California

The story of the financing response in California is very simple. The state sets employer taxes using reserve ratios. There are eight tax schedules that range from AA (lowest) to F+ (highest). The range of tax rates on schedule F+ is from 1.50 percent to 6.21 percent. California has operated on schedule F+ for all years since 2005. The taxable wage base has been \$7,000 per employee in every year since 1983. Because the state was already on the highest tax schedule with an unchanging tax base, the only way for tax revenue to increase after 2007 would have been through employment growth or changes in the average experience-rated tax rate. Table A1 shows that between 2006 and 2010 tax revenue was consistently between \$4.08 billion and \$4.87 billion, it but did increase to \$5.90 billion in

²² This discussion includes all 50 states plus the District of Columbia but not Puerto Rico and the Virgin Islands.

²³ Reserve ratio systems use reserves on a set computation date to establish future tax rates while benefit ratio systems use the flow of charged benefits to set individual employer tax rates.

2011. Thus taxes in 2011 were about one-quarter higher than in 2007. The higher revenue was only due to the effect of experience rating with no change in the tax base or tax schedules. Since 2007 the state has borrowed more than \$10.0 billion from the Treasury. At the end of May 2012 the loan balance was \$8.5 billion.

Table A1. Annual UI Tax Revenue 2006 to 2011 (\$ millions)

	2006	2007	2008	2009	2010	2011	2010/ 2007	2011/ 2007
California	4,871	4,753	4,490	4,083	4,433	5,900	0.93	1.24
Texas	1,563	998	950	1,085	2,249	2,405	2.25	2.41
New York	2,397	2,166	2,121	2,147	2,607	2,808	1.20	1.30
Florida	1,127	880	775	757	1,121	1,671	1.27	1.90
Illinois	2,511	2,228	1,853	1,437	1,829	2,610	0.82	1.17
Pennsylvania	2,300	2,207	2,030	1,855	2,212	2,834	1.00	1.28
Ohio	1,067	1,050	1,045	1,018	1,157	1,427	1.10	1.36
New Jersey	1,518	1,812	1,836	1,774	2,123	2,545	1.17	1.40
Georgia	621	524	490	483	628	721	1.20	1.38
North Carolina	933	899	868	736	760	861	0.85	0.96
Michigan	1,516	1,541	1,495	1,303	1,418	1,641	0.92	1.06
Virginia	517	405	324	303	502	675	1.24	1.67
Massachusetts	1,595	1,501	1,425	1,429	1,577	1,764	1.05	1.18
Total—Big13 States	22,539	20,966	19,703	18,411	22,618	27,861	1.08	1.33
U.S.—51 States	33,917	31,500	29,839	28,029	35,744	44,417	1.13	1.41
Other 38 States	11,378	10,533	10,136	9,618	13,125	16,556	1.25	1.57

Source: U.S. Department of Labor, Employment and Training Administration—Office of Unemployment Insurance, “Financial Handbook” and ETA-2112 reports.

Texas

Texas operates with a benefit ratio experience-rating system that sets employer taxes using the average benefit ratio from the preceding three years. Texas began borrowing in July 2009 and by December 2010 it had borrowed nearly \$2.0 billion from the Treasury. In December 2010 Texas issued \$1.96 billion in municipal bonds, using the proceeds to fully repay its Treasury loans. The bonds have maturity dates extending to 2020, but some have call features allowing early repayment if the recovery were to proceed strong-

ly. By the end of 2011 the state had repaid more than \$200 million early in addition to \$118 million in scheduled bond redemptions. This strategy has allowed the state to save on interest charges and avoid FUTA tax credit reductions but has created future repayment obligations that extend for six to nine years depending upon the pace of debt repayment.

During both 2010 and 2011 regular UI trust fund revenues have responded strongly in Texas as underlying employer benefit ratios have increased due to higher benefit payouts from mid-2008 through 2010. Tax revenue during the two most recent years was more than twice 2007 revenue. At the end of May 2012, however, state net indebtedness was about \$1.5 billion.

New York

New York entered the recession with extremely low reserves. Its \$430 million trust fund balance at the end of 2007 represented an RRM of just 0.04, or about half a month of benefits. The state started borrowing in the first months of 2008, owing the Treasury more than \$3.7 billion at the end of February 2012 and more than \$2.6 billion at the end of May. Tax revenue in 2011 was 30 percent higher than in 2007 (\$2.81 versus \$2.17 billion), totally the result of the experience-rated response of taxes under its reserve ratio tax system. The taxable wage base has remained \$8,500 since 1999. During 2010, 2011, and 2012 employers have been taxed using the highest tax rate schedule, with an increased subsidiary tax applicable in 2012.

Florida

Florida sets tax rates using three-year benefit ratios. The state entered the recession with a taxable wage base of \$7,000 but legislation passed in 2011 raised it to \$8,500 in 2012. However, in early 2012 the state lowered the base to \$8,000 effective in January 2012. Under current law the tax base will revert to \$7,000 in 2015. With a tax base of just \$7,000 in 2010, the taxable wage proportion (taxable wages as a proportion of total wages) was 0.214. Total revenue in 2011 was \$1.67 billion, or 90 percent higher than in 2007. Under the state's system of three-year benefit ratio experience rating, the lagged increase in benefit payouts has caused the average tax rate to increase. However, Florida has restricted tax increases by overriding an important solvency provision. The tax statute includes a positive adjustment factor operative whenever the trust fund balance falls below 4.0 percent of taxable wages. This adjustment was not allowed to operate fully during 2010, 2011, or 2012.

The state started borrowing in August 2009 and owed the Treasury \$1.77 billion at the end of 2011. At the end of May 2012 its debt had been reduced to \$0.59 billion.

With an excess of taxes over benefit payouts of less than \$100 million in 2011, the prospect is for indebtedness to last for two or three more years.

During 2011 benefits were restricted through reduction in maximum weeks of regular UI benefits. The law included a sliding scale for maximum weeks, with a range from 23 weeks in years of highest unemployment down to as low as 12 weeks when unemployment is low. Florida was one of six states to legislate a maximum benefit duration of less than 26 weeks during 2011. It had been 40 years since any state had had a maximum duration of fewer than 26 weeks.

Illinois

Illinois sets UI tax rates using three-year benefit ratios to measure employer experience. Following a period of trust fund indebtedness that commenced in 2003, it instituted measures to improve solvency. The changes affected mainly UI taxes with tax base increases occurring in most years between 2003 and 2008. Tax base increases have continued through the Great Recession, with the base reaching \$12,520 in 2010 and \$13,560 in 2012. While the tax base has increased, the increases have been modest and the taxable wage proportion (TWP) has remained low. In 2010 the TWP was 0.266, securing revenue from about one-fourth of total payroll.

The 2003 legislation also strengthened the fund balance tax that increases revenues more aggressively during periods of low reserves. This tax has been operative in every year since 2004. Despite the added taxes intended to assure solvency, Illinois started to borrow in July 2009. Total indebtedness was \$2.1 billion at the end of December 2011 and \$1.0 billion at the end of May 2012. Taxes paid by employers in 2011 were only 17 percent higher than in 2007.

During 2003–2006 Illinois borrowed in the private bond market, issuing about \$700 million in bonds. These saved the state on interest charges (lower rates than the rates on Treasury loans) and were fully repaid during 2006. This earlier experience with private bonds was viewed favorably by all stakeholders in Illinois. During December 2011 the state authorized the issuance of \$2.4 billion in bonds, but is still working on the details of a new issuance anticipated for the summer or fall of 2012. The maximum duration of the bonds can be up to 10 years.

Illinois enacted solvency legislation in 2011 that emphasized UI benefit reductions. The maximum benefit duration for regular UI was reduced to 25 weeks in 2012 and to 24 weeks in 2016. The statutory replacement rate (currently 49 percent) will be reduced to 42.8 percent in 2016. Provisions to improve recovery of overpayments and to ease the ability of employers to challenge benefit payments were part of the same legislation. The solvency adjustment consists mainly of benefit reductions and deferral of much of tax increases to later years when the (yet-to-be-issued) bonds mature. Private bond in-

debtedness can extend to 2021. While the Illinois strategy will save on interest charges and prevent further FUTA credit reductions, the net trust fund balance will likely remain negative for several years after 2012.

Pennsylvania

In the late 1980s Pennsylvania instituted a system of trust fund financing that proponents described as flexible financing. They argued that the flexibility features would be activated automatically when trust fund balances declined, preventing large-scale borrowing and restoring the trust fund without the need for solvency legislation. The system had four flexibility components: two employer taxes, an employee tax, and a reduction of weekly benefits. All four are controlled by the trust fund balance ratio (reserves as a percentage of lagged payroll on June 30) and operate with increasing “bite” as the trust fund balance decreases.

This system worked reasonably successfully during the recessions of 1991–1992 and 2001–2002 but proved inadequate during the Great Recession. All four flexibility features were fully activated during 2010, 2011, and again in 2012. However, the combined total annual impact of the four features falls into the \$600–\$650 million range and the increase in benefit payouts during 2008–2011 swamped their combined effects. As a result, Pennsylvania, which started borrowing in March 2009, has accumulated a large debt that totaled \$3.2 billion at the end of December 2011 and \$3.9 billion at the end of May 2012.

During 2011 the inadequacy of the state’s flexible financing system was acknowledged with legislation to improve solvency. However, the adjustments were made on the benefit side of trust fund flows. Specific adjustments included increasing the weekly amount (from \$35 to \$70) needed to receive a credit week for base period earnings, raising the number of credit weeks needed for monetary eligibility (from 16 to 18 weeks), reducing potential duration for persons with fewer than 26 credit weeks, creating a severance pay offset, establishing an active work search requirement and reducing future growth in the maximum weekly benefit. The tax base remained at \$8,000 where it had been since 1984 and no new taxes were proposed. Thus even if a strong turnaround in the state economy takes place, debts will persist for several more years. Tax revenue during 2011 was just 28 percent higher than in 2007 and total benefit payments in 2011 exceeded total revenue by more than \$200 million. Flexible financing worked during two small recessions but not during the Great Recession. Pennsylvania has not yet proposed a strong solvency package, and is likely to explore a bond issuance later this year.

Ohio

Ohio sets employer taxes under reserve ratio experience rating and finances its UI program with three taxes: an experience rated basic tax, a mutualized tax and a minimum safe level tax. However, the total response of the tax system through 2011 has been limited. The tax base has not changed from the \$9,000 first established in 1995. With this low base, UI taxable wages in 2010 were less than one quarter (0.242) of covered wages. Also limiting the tax response has been a consistent policy of assigning half of the minimum safe level (MSL) tax to defray part of mutualized charges. Because of this diversion, only half of MSL has been used to raise the trust fund balance. During the four years from 2008 to 2011 roughly \$700 million of MSL taxes was used to defray mutualized charges rather than increasing the trust fund balance. Despite a large UI trust fund debt, tax receipts in 2011 were only 36 percent higher than in 2007.

Ohio had just \$440 million in its trust fund at the end of 2007 and began borrowing in January 2009. Total indebtedness at the end of December 2011 was \$2.0 billion and at the end of May 2012 it was \$1.5 billion. Total regular benefits in 2011 exceeded tax receipts by \$300 million. Unless major changes affecting solvency are implemented, the prospect is for the state to carry debts for four or more years even with FUTA credit offsets increasing each year after 2011.

New Jersey

New Jersey determines employer taxes using the reserve ratio system of experience rating. The tax statute has five tax rate schedules with lowest rates on Schedule A and highest rates on Schedule E. Its UI program has an indexed taxable wage base set at 28 times the average weekly wage in covered employment (effectively 53.8 percent of statewide annual earnings). New Jersey is one of only two of the largest states (along with North Carolina) with an indexed taxable wage base. It also can levy UI payroll taxes on covered employees.

New Jersey entered the Great Recession with a very low reserve balance. Its \$650 million at the end of 2007 represented a RRM of only 0.11. The state started borrowing in March 2009. Total loans were \$1.4 billion at the end of December 2011 and \$0.9 billion in May 2012.

Following the onset of the Great Recession, UI tax revenue in New Jersey has responded at about the same pace as the national average. Revenue in the two years 2010 and 2011 was respectively 17 and 40 percent higher than in 2007. During the past four years, tax revenue would have been higher had the state allowed experience rating to operate as specified in its tax statute. The operative tax schedule during 2009 and 2010 was Schedule A and then Schedule C applied during 2011 and 2012. The statute called for Schedule E in all four years. Thus much of the state's current indebtedness reflects a

political decision to override the tax statute and prevent the associated increases in UI tax revenue. As a result, New Jersey is probably facing two or three more years of trust fund indebtedness.

Georgia

Georgia determines employer tax rates using reserve ratio experience rating. At the end of 2007 its trust fund balance of \$2.18 billion represented an RRM of 0.43. The rapid growth of benefit payments in 2008 and 2009 exhausted the trust fund and borrowing commenced in December 2009. Loans at the end of December 2011 totaled \$0.6 billion and \$0.7 billion at the end of May 2012.

Georgia initiated a two-part solvency response in 2012. The maximum potential duration of regular UI benefits was reduced from 26 weeks. In future years the maximum will vary between 20 and 12 weeks with more weeks available in years of high unemployment. Earlier 2012 legislation also substantially raised employer UI taxes. Employers were notified in mid-March that 2012 tax rates would be some 30 to 40 percent higher than the rates designated in an earlier tax notice sent at the end of 2011. Both changes will improve trust fund solvency.

Georgia's tax base has been \$8,500 since 1990. By 2010 the TWP had decreased to 0.227. Taxes only started to respond in 2010. The increases in 2010 and 2011 over 2007 were 20 and 38 percent respectively. In 2011, benefits exceeded UI taxes by more than \$200 million. With higher tax rates and reduced benefits, the 2011 gap between revenue and benefits will be reduced if not eliminated in 2012. However with a current debt that exceeds \$700 million, Georgia may have outstanding loans for two or three more years.

North Carolina

North Carolina has an indexed taxable wage base. The base, set at 50 percent of lagged statewide average annual earnings, is \$20,400 in 2012. Despite the high tax base the state has had financing problems. It borrowed during the recession of 2001-2002 and again during the Great Recession. Indebtedness at the end of December 2011 was \$2.4 billion and \$2.2 billion at the end of May 2012.

North Carolina sets tax rates using reserve ratio experience rating. For employers with positive account balances annual tax rates are set with nine different tax schedules. Schedule H has the lowest rates and Schedule A has the highest rates. Employers with negative balances face a single schedule with a maximum tax rate of 5.7 percent. When the trust fund falls below 2.0 percent of payroll, the highest tax schedule is operative for all employers. Since 2009 positive balance employers have been taxed under Schedule A

and tax rates have included a 20 percent add-on. Thus the maximum tax rate since 2009 has been 6.84 percent of taxable payroll.

Total UI tax revenue has responded more slowly in North Carolina than in the other 13 biggest states. Total UI taxes in 2011 (\$861 million) were four percent lower than in 2007 (\$899 million). During 2011 regular UI benefit payments exceeded total tax revenue by more than \$500 million. To improve solvency it seems the tax rates on the high tax schedules need to be increased. The prospect of returning to a zero balance, much less a robust trust fund balance is unlikely until sometime late in the current decade. Of the 13 largest states, North Carolina's net indebtedness relative to covered payroll (about 2.0 percent) is the largest.

Michigan

Michigan was the only state UI program that entered the Great Recession with a negative trust fund balance, -\$103 million at the end of 2007. Like Pennsylvania, Michigan determines employer taxes using a combination of benefit ratios and reserve ratios. The state's economy never fully recovered from the previous recession. Thus the trust fund balance which had exceeded \$2.0 billion at the end of 2002 decreased in each succeeding year. The pace of decline then increased during 2007-2009. At the end of November 2011 Michigan owed \$3.14 billion.

During December 2011 the state borrowed \$3.32 billion in the private bond market using very short term instruments (with very low interest rates). Later this year it plans to issue longer term instruments, but the details of the issuance are still being determined. It is likely the instruments will have maturities of up to six years or longer. Michigan recommenced borrowing from the Treasury in early 2012, but these new loans were fully repaid during April-May 2012 using first-quarter tax accruals. Net trust fund indebtedness (including private debt) at the end of May 2012 was \$2.7 billion.

Michigan's December 2011 legislation also included provisions to improve program solvency. The tax base was increased from \$9,000 to \$9,500 in January 2012. Several benefit reductions were also enacted. Maximum duration in the regular program was reduced from 26 to 20 weeks in January 2012. Greater efforts at overpayment identification and recovery were also enacted.

Michigan's tax statute calls for a solvency tax with a rate of 0.75 percent to be levied on negative balance employers. This tax has been waived in recent years and is a factor that has limited the response of UI taxes to the loss of trust fund reserves.

Like most of the other largest states Michigan is facing a multiyear period of trust fund debts. The anticipated bond issuance will change the form of the debt but will not alter the fact of substantial indebtedness. The state originally borrowed \$3.32 billion in the private market in late December 2011.

Virginia

Virginia sets employer tax rates using benefit ratios based on the last four years of experience. There are 63 different rate schedules but all have a range of 6.1 percentage points between the lowest rate (for the best experience) and the highest rate (for the worst experience). The state has operated with a tax base of \$8,000 since 1991. Taxable wages in 2010 were less than 20 percent (0.191) of total covered wages. Virginia had \$775 million of reserves prior to the Great Recession but an RRM of only 0.45, and it started borrowing in December 2009. Indebtedness at the end of December 2011 was \$275 million. In April and May 2012 Virginia repaid all of its Treasury loans. Its net trust fund balance at the end of May was \$120 million.

To this point, Virginia has not enacted any legislation to improve solvency. Through its experience-rating response, tax revenue in 2011 was 67 percent higher than in 2007. Compared to the other large states, the scale of Virginia's borrowing was modest and its debts have been fully repaid.

Massachusetts

Massachusetts uses reserve ratios to set employer UI tax rates. Its tax statute has seven tax rate schedules ranging from Schedule A (lowest tax rates) to Schedule G (highest rates). Massachusetts, a high wage state, has twice enacted solvency legislation that raised its tax base; to \$10,800 in 1992 and to \$14,000 in 2004. Because of its high wages, however, the taxable wage proportion (TWP) has decreased despite raising the tax base. In 2010 the TWP was 0.287. Discussions are currently underway to raise the tax base.

Massachusetts entered the Great Recession with a reserve balance of \$1.29 billion but an RRM of only 0.28. It started borrowing in February 2010 but total loans never reached \$400 million. The repayment of loans from 2010 and 2011 was completed before October of both years thus avoiding interest charges and FUTA credit reductions. The state again borrowed during January - April 2012, but fully repaid its loans in May 2011. Absent a renewed recession, the state thinks it will not borrow in later months of 2012 or in later years.

State officials identify two factors that have prevented large scale borrowing. First, the increase in payouts from the Great Recession was smaller than in many other states. The increase in benefit payments between 2007 and 2009 was 102 percent in Massachusetts compared to an average of 149 percent nationwide. Second, Massachusetts received \$163 million in ARRA modernization payments that provided a useful infusion into the trust fund during 2009 when the fund was decreasing rapidly.

Massachusetts would have experienced even less borrowing had the state followed its experience-rating statute. However, there is a history extending back more than 20 years of enacting temporary laws to override the experience-rating statute. During the

three years 2010-2012, for example, Schedule E was in force when it should have been Schedule G. The implied annual revenue loss exceeded \$200 million for each of these three years. Despite these tax reductions, Massachusetts is the only one of the 13 largest states that ended 2011 with a positive trust fund balance.²⁴ The state's trust fund balance at the end of May 2012 was \$0.575 million.

13 State Summary

The bottom three lines in Table A1 summarize revenue patterns during 2006-2011 for the aggregate system and for two sub-groups of states, the 13 largest discussed above and the remaining 38. For the United States, revenue in 2010 was 13 percent higher than in 2007 and 41 percent higher in 2011. For the 13 largest states the corresponding revenue increases over 2007 were 8 percent and 33 percent respectively.

Because of their combined size in the UI system, the 13 largest states exert a strong influence on overall revenues. For the other 38 states, the bottom line of Table A1 shows that combined revenue in 2010 was 25 percent higher than in 2007 and then 57 percent higher in 2011. Because of the more rapid revenue growth in the group of 38, their share to total UI tax revenue increased from 33.4 percent in 2007 to 37.3 percent in 2011.

The combined effects of lower pre-recession reserves and slower post-2007 revenue growth mean that the outstanding UI debts of the 13 largest states will represent a continuing problem for some four to seven years into the future. Borrowing in the private bond market does reduce interest costs and FUTA tax credit offsets, but private bonds remain debt obligations that must be repaid. Considering the private bonds as well as the Treasury loans the total indebtedness of the 51 programs at the end of December 2011 was \$41.6 billion. Of this total, \$32.4 billion or 77.9 percent was owed by the 13 largest states. The parallel statistics for the end of May 2012 were \$26.8 billion of \$34.6 billion, or 77.5 percent owed by the 13 largest states.

How large is this debt? In 2011 the 51 programs had combined tax revenue of \$44.4 billion and regular UI benefit payouts of about \$43.0 billion. Thus the indebtedness of the overall system represented 94 percent of annual revenue in 2011 in a system where 2011 total revenue exceeded total regular UI benefit payments by less than \$1.5 billion. With the current recovery progressing, total regular UI benefit payments in 2012 may be roughly \$35.0 billion. Total indebtedness at the end of 2012 will likely exceed \$30 billion. The remaining debt is large and likely to persist for several of the biggest states for some four to eight years.

²⁴ This statement is based on calculations that include the private debt obligations of Michigan and Texas.

To summarize, five factors have combined to yield a sluggish revenue response for the 13 largest states.

1. Two states were already on their highest tax rate schedule at the start of the Great Recession (California and North Carolina).
2. Five have enacted legislation that reduced the growth in revenue that would have occurred automatically under the state's experience-rating statute (Florida, Massachusetts, Michigan, New Jersey, and Ohio).
3. Six emphasized benefit reductions as a way to defer and/or reduce the level of future UI taxes (Florida, Georgia, Illinois, Michigan, Pennsylvania, and Texas).
4. Although five did institute higher taxable wage bases, the increases were either automatic due to indexation (New Jersey and North Carolina) or small (Florida, Illinois, and Michigan).
5. Three have already committed to borrowing in the private bond market (Illinois, Michigan, and Texas). The issuance of private debt instruments will reduce loans owed the Treasury but will not per se improve these states' long run trust fund balances.

Thus the small aggregate response of revenues for the 13 largest states reflects the combined effects of several factors with a single motivation: to reduce the increase in UI taxes paid by employers. The most obvious consequence is to delay the restoration of large, positive UI trust fund balances in our largest state UI programs.

ANNEX B.

United States Exceptionalism

The unemployment compensation (UC) system in the United States (U.S.) is unique. Certain U.S. institutional features are not found in other economies while some features present several other UC systems are absent here. Tables B1 and B2 help illustrate U.S. exceptionalism by summarizing key aspects of UC program financing and benefit payments in 22 advanced economies. All are members of the Organization for Economic Cooperation and Development (OECD). They include four from Scandinavia, six from Western Europe, four from Southern Europe, six English speaking and two from Asia. The 22 include all G7 members (identified with boldfaced type in both tables). Their combined output accounts for about half of world GDP.

Several features of the U.S. system stand out in table B1. We are unique in operating a system with different laws in individual states governing taxes and benefits. The other 21 countries operate a unitary system with a nationwide UC statute for both taxes and benefits.²⁵ Our UC system includes a mixture of national and state laws.

Except for Australia and New Zealand, the other countries all pay unemployment insurance (UI) benefits where eligibility is contingent upon sufficient past work in covered employment. Nearly all UI systems link benefit levels to past earnings.²⁶ Eligibility is mainly reserved for job losers, i.e., employer-initiated separations, and recipients must be available for and actively seeking work. Ten countries with UI programs also pay unemployment assistance (UA) benefits to persons who do not qualify for UI or have exhausted (used up) their UI entitlement (column (3)). Eligibility for UA is also conditioned on the applicant being able and available for work and with total income that falls below a designated threshold. The U.S. is one of ten countries in table B1 that does not pay UA benefits. The U.S. approach to exhaustions is to extend potential UI duration during recessionary periods. In 2010 and 2011 many U.S. exhaustees were entitled to 99 weeks of UI benefits, 26 weeks from the first tier of eligibility (so-called regular UI) and up to 73 weeks from two long term benefit programs (Emergency Unemployment Compensation or EUC and Extended Benefits or EB). With legislation of February 2012, maximum duration will be reduced in the later months of 2012, but it will still exceed 70 weeks for many who exhaust regular UI.

²⁵ In fact, of the approximately 60 UC systems throughout the world, China has the only other system with substantial subnational statutory underpinnings that determine benefits and financing.

²⁶ Ireland and the United Kingdom are exceptions, paying flat benefits in their UI systems.

Table B1. Unemployment Compensation Tax Provisions in 22 Advanced Economies

	National UC Law	UI Benefits	UA Benefits	General Revenue	Employer Payroll Tax	Employee Payroll Tax	Experience Rating	Taxable Wage Proportion	Statutory Tax Rate (%)	Effective Tax Rate (%) (10) = (8)*(9)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	
Australia	Yes	No	Yes	Yes	No	No	No	NA	NA	NA
Austria	Yes	Yes	Yes	No	Yes	Yes	No	0.87	6.00	5.24
Belgium	Yes	Yes	No	No	Yes	Yes	No	0.72	2.33	1.68
Canada	Yes	Yes	No	No	Yes	Yes	No	0.77	5.15	4.00
Denmark	Yes	Yes	No	No	Yes	Yes	No	1.00	8.00	8.00
Finland	Yes	Yes	Yes	No	Yes	Yes	No	1.00	2.84	2.84
France	Yes	Yes	Yes	No	Yes	Yes	No	0.75	6.08	4.56
Germany	Yes	Yes	Yes	No	Yes	Yes	No	0.77	5.11	3.94
Greece	Yes	Yes	No	No	Yes	Yes	No	0.80	4.20	3.34
Ireland	Yes	Yes	Yes	No	Yes	Yes	No	0.85	a	a
Italy	Yes	Yes	No	No	Yes	No	No	1.00	1.61	1.61
Japan	Yes	Yes	No	No	Yes	Yes	No	1.00	1.66	1.66
Korea	Yes	Yes	No	No	Yes	Yes	No	1.00	1.50	1.50
Nether- lands	Yes	Yes	Yes	No	Yes	Yes	No	0.82	8.33	6.80
New Zealand	Yes	No	Yes	Yes	No	No	No	NA	NA	NA
Norway	Yes	Yes	No	No	Yes	Yes	No	1.00	a	a
Portugal	Yes	Yes	Yes	No	Yes	Yes	No	1.00	5.22	5.22
Spain	Yes	Yes	Yes	No	Yes	Yes	No	0.88	7.35	6.45
Sweden	Yes	Yes	Yes	No	Yes	Yes	No	1.00	b	b
Switzer- land	Yes	Yes	No	No	Yes	Yes	No	0.90	2.20	1.97
United Kingdom	Yes	Yes	Yes	No	Yes	Yes	No	0.82	a	a
United States	No	Yes	No	No	Yes	No	Yes	0.28	2.38	0.68
Total or Average	21	20	12	2	20	18	1	0.86	4.37	3.72

Source: Calculations based mainly upon *Social Security Programs Throughout the World* (<http://www.ssa.gov/policy/docs/progdesc/ssptw/>) averages for the five years 2002, 2004, 2006, 2008, and 2010.

Notes: U.S. calculations are 2001–2010 averages. The bottom row shows counts of yesses or simple averages from the countries where estimates are shown. Estimated taxable wage proportions do not account for low earnings thresholds that are not subject to payroll taxes. Countries in bold are members of the G7.

NA = not applicable (there is no UI payroll tax).

a. UI taxes included in overall social security taxes

b. Details not provided in SSPTW

Except for Australia and New Zealand, all countries in table B1 use payroll taxes to finance UI benefit payments (column (5)). Typically payroll taxes are levied on both employers and workers with either all or most of worker wages subject to taxation. Of the 20 systems with payroll taxes, only the U.S. and Italy do not levy a payroll tax on employees.²⁷ Table B1 also shows that the base for the UI payroll taxes in most countries covers the majority of wages and salaries. Note in column (8) that eight countries tax wages without an upper limit, hence, their taxable wage proportion is 1.00. The estimated taxable wage proportion exceeds 0.70 in all but one country with UI payroll taxes. The exception is the United States where the taxable wage proportion averaged 0.28 between 2001 and 2010. Because of the low taxable wage proportion, the effective tax rate on total payroll in the U.S. averaged just 0.68 percent during the 2001-2010 decade, the only percentage below 1.00 in column (10) of table B1.

Table B2 summarizes key UC benefit provisions for these economies. For most programs (16 of 22) entry eligibility (column (1)) depends on weeks of employment during a recent base period, and for 12 of the 16 the base period exceeds 52 weeks. Entry eligibility for the other six economies includes two (Australia and New Zealand) with no prior work requirement, three that utilize a minimum earnings threshold (Norway, the UK and the United States²⁸) while Canada uses pre-unemployment hours worked in its minimum threshold. The past work requirement in the U.S. is lower than in the other 21 economies, although it is similar to the UK requirement. Except in Australia and New Zealand, UC beneficiaries are predominantly job losers where employers have initiated the separation due to a lack of work (as opposed to disciplinary separations).

Table B2 shows wide variation in statutory replacement rates (the share of lost earnings replaced by UC benefits) and maximum potential durations (columns (2) and (3)). About half replace more than 55 percent of past earnings, often using a payment schedule where the replacement rate decreases in later weeks of eligibility. Nearly all systems pay benefits for more than the 26 weeks typical of the U.S. The 99 weeks of eligibility operative during 2010 and 2011 reflects extended benefits paid to those who exhaust their initial 26 weeks of eligibility under the so called regular UI program. In many countries, maximum potential duration is longer for those with longer past work histories. Maximum duration exceeds 52 weeks in 16 of the 22 programs.

²⁷ In a few U.S. states there are employee UI payroll taxes: Alaska, New Jersey and Pennsylvania in 2012.

²⁸ The requirements in the U.S. vary from state to state.

Table B2. Unemployment Compensation Benefit Provisions in 22 Advanced Economies

	Base Employ. Eligibility (weeks)	2002–2010 Statutory Replacement Rate %	2002–2010 Max. Duration (weeks)	2000–2007 UI Benefit Cost Rate %	2000–2007 UA Benefit Cost Rate %	2000–2007 Total Benefit Cost Rate %
	(1)	(2)	(3)	(4)	(5)	(6)
Australia	0	25	No Limit	NA	1.386	1.386
Austria	22 of 52	55	20–62	1.055	0.631	1.686
Belgium	45 of 78	66–40	65	7.148		7.148
Canada	420 hours	55	14–45	1.460		1.460
Denmark	52 of 156	90	208	1.976		1.976
Finland	43 of 121	45	100	2.016	1.404	3.420
France	21 of 93	75–57	24–113	4.138	0.512	4.650
Germany	52 of 125	67–60	23–108	2.276	1.606	3.882
Greece	25 of 61	50–40	22–52	0.963		0.963
Ireland	39 of 52	Flat	62	0.795	1.166	1.961
Italy	52 of 104	48–42	30	1.063		1.063
Japan	36 of 73	80–54	13–33	0.231		0.231
Korea	31 of 78	50	13–34	0.522		0.522
Netherlands	26 of 38	70	26–222	1.677	2.116	3.793
New Zealand	0	25	No Limit	NA	1.791	1.791
Norway	14 of 52 ^a	56	68–125	1.294		1.294
Portugal	70 of 104	65	52–130	2.598	0.697	3.295
Spain	52 of 312	70–60	17–104	2.384	0.822	3.206
Sweden	26 of 52	80–70	43–65	2.696	0.132	2.828
Switzerland	47 of 104	80–70	34–92	1.143		1.143
United Kingdom	4.1 of 52^a	Flat	26	0.067	0.288	0.355
United States	3.2 of 52^a	55–50	26	0.607		0.607
Averages	35 of 93	64–57	44–85	1.805	1.046	2.212

Source: Calculations based mainly upon *Social Security Programs Throughout the World* (<http://www.ssa.gov/policy/docs/progdesc/ssptw/>), averages for the years 2002, 2004, 2006, 2008, and 2010.

Notes: U.S. calculations are 2001–2010 averages. The bottom row shows simple averages from the countries where data are shown. Countries in bold are members of the G7.

NA = not applicable

a. Minimum monetary earnings threshold expressed in weeks, measured at national average weekly wages. The U.S. entry is the average across 51 state programs.

Columns (4), (5) and (6) of table B2 show benefit cost rates for the eight years prior to the Great Recession, i.e., 2000 to 2007. Average costs as a percent of payroll are shown for UI and UA separately as well as their combined costs. These estimates summarize benefit costs in the two systems designed to serve unemployed workers. Other income support costs not included in these estimates are income-conditioned support programs (social assistance, food assistance housing assistance and tax supports for low income families). Note that total costs fall below 1.0 percent of payroll in just five countries, (Greece, UK, the United States, Japan, and Korea). Except for its low entry eligibility requirement, the benefit provisions for the United States describe a spare UI system.

About the Author

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