

Re-financing California's UI System

The Problem

- ✓ Trust Fund currently faces fiscal insolvency
- ✓ UI Trust Fund loan will add additional costs to the system
- ✓ Trust Fund financing structure currently (1) does not build reserves that are adequate to provide decent benefits during economic recessions, and (2) charges employers higher taxes during economic recessions when they are least able to pay.

The Solution

- ✓ Federal bail out loan (short term)
- ✓ Move toward a “forward-funded” financing structure that generates reserves to ensure that:
 - Unemployed workers have adequate access to decent benefits, and
 - Employers do not pay the highest tax rates during economic recessions.

HOW THE UI FINANCING SYSTEM WORKS

TWO FACTORS DETERMINE HOW MUCH EMPLOYERS PAY INTO THE UI TRUST FUND

- Each employer pays a certain **UI Tax Rate**
- That Tax Rate is paid on the “**Taxable Wage Base**”

Individual employer contribution = UI Tax Rate * Taxable Wage Base

What determines an employer's UI Tax Rate?

UI tax rate is currently determined by two factors: overall health of the Trust Fund, and an individual employer's experience rating

Overall health of the Trust Fund

- ✓ The Trust Fund balance ratio is used to measure the overall health of the UI Trust Fund
- ✓ Trust Fund balance ratio = Fund balance/total covered wages
- ✓ Each trust fund balance ratio is attached to one of seven different UI tax schedules (see below)

If Trust Fund balance ratio is	Use schedule
Greater than 1.8 percent	AA (most favorable)
1.6% - 1.8%	A
1.4% - 1.6%	B
1.2% - 1.4%	C
1.0%-1.2%	D
0.8%-1.0%	E
0.6% - 0.8%	F
Below 0.6%	F schedule plus 15%

Individual experience rating of the employer

- ✓ Within each tax schedule, an individual employer pays a tax rate determined by their experience rating
- ✓ The experience rating formula is known as the employer's “reserve account”
- ✓ Employer's reserve account = (contributions made – benefits charged)/ (average taxable payroll for the last 3 years)

What determines the Taxable Wage Base? All California employers pay their UI tax rate on a taxable wage base of \$7,000.

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POLICY OPTIONS FOR RE-FINANCING CALIFORNIA'S UI SYSTEM

California currently has a UI system that does not collect funds during economic good times that are adequate to provide decent benefits during a recession. In addition, the current system ends up charging employers the highest tax rates during economic recessions when they are least able to pay.

California needs a “forward-funded” UI system that builds reserves that are adequate to ensure that:

- ✓ Unemployed workers can access decent benefits, and
- ✓ Employers do not pay the highest tax rates during economic recessions

Below are the most useful policy options for moving California toward a “forward-funded” UI system. These can be done individually or more than one could be changed at the same time.

OPTION ONE: INCREASE THE TAXABLE WAGE BASE

California's taxable wage base of \$7,000 is the federal minimum (see state by state-by-state comparison table attached). There are two options for increasing the taxable wage base

- ✓ Increase by a flat dollar amount
 - If a taxable wage base was the only change made to the UI system, the taxable wage base would need to be increased to at least \$15,000 to move Trust Fund into healthier position (see attached EDD figures)
- ✓ Index to the state's average annual wage
 - **Numerous states** tie their taxable wage base to a % of the average annual wage
 - California's average annual wage is about \$42,000
 - EDD figures show that tagging to 50 percent of the average annual wage builds up reserves that are too large (50 percent of the AAW amounts to \$20,814 in 2003)
 - A good index would be about 42 percent of average annual wage
 - Employers hate indexing

OPTION TWO: ATTACH THE UI TAX SCHEDULES TO HIGHER TRUST FUND BALANCES

As mentioned above, the UI system shifts from one tax schedule to the next depending on the health of the UI Trust Fund. The health of the Fund is measured by the “Trust Fund Balance Ratio,” which equals the Trust Fund balance divided by the total payroll from the previous year.

Under the current system, employers fall under the most favorable tax schedule (the AA schedule) when the Trust Fund balance equals at least 1.8 percent of the total covered payroll.

Many other states have a far higher target at which employers pay on the most favorable tax schedule (see chart). In many states, employers don't pay on the most favorable tax schedule until the Trust Fund balance equals at least 5 percent of the total covered payroll.

California would generate greater trust fund reserves if it increased the Trust Fund balances that trigger particular tax schedules. The following modified schedule changes these triggers and raises the Trust Fund balance associated with the least favorable tax schedule.

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Current	Modified	
If ratio is	If ratio is	Use schedule
Greater than 1.8 percent	Greater than 4 percent	AA (most favorable)
1.6% - 1.8%	3.5% - 4.0%	A
1.4% - 1.6%	3.0% - 3.5%	B
1.2% - 1.4%	2.5% - 3.0%	C
1.0%-1.2%	2.0% - 2.5%	D
0.8%-1.0%	1.5% - 2.0%	E
0.6% - 0.8%	1.0% - 1.5%	F
Below 0.6%	Below 1.0%	F schedule plus 15%

This change would move California a real step forward toward a forward-funded system. Essentially the change means that California is setting a higher target for solvency in the UI Trust Fund.

However, this change would have no impact until the Trust Fund emerges from a negative balance, so it would have to be combined with another strategy (either a higher taxable wage base or higher tax rates) that pulls more money into the Fund immediately.

We are currently working with the EDD produce estimates of how possible changes to the tax schedule triggers would impact the UI Trust Fund.

OPTION THREE: INCREASE THE TAX RATES

A third re-financing option would be to increase the tax rates within each tax schedule. Two possible options:

- ✓ Increase only the maximum tax rate
 - California's maximum tax rate is at the federal minimum of 5.4 percent, some states have maximum tax rates over 9 percent
 - See chart attached for state-by-state comparisons of maximum tax rates
 - Data from the EDD shows a significant increase recently in the amount of money lost from employers who underpay because of the maximum tax rate
 - An increase in the maximum tax rate would disproportionately impact those sectors with high experience ratings – agriculture, construction, entertainment
 - Fiscal impact is difficult to determine: EDD says that they do not have the capacity to estimate the fiscal impact of increases in the maximum tax rate
- ✓ Increase maximum tax rate and all other tax rates within each tax schedule
 - Same problems of disparate impacts on sectors
 - Again, EDD currently not able to assess fiscal impact