



THREE DEMONSTRATION OPTIONS TO MODERNIZE UI POLICY AND EMPOWER STATES

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Background:

The basic structure of the UI system has been set in law since 1935. The structure of the system, though, has seen little significant change in the nearly 80 years it has existed. With the economy in a strong current position, this is the best time to step back and re-evaluate the basic UI structure.

We can learn lessons from other programs. Unlike UI, a similar payroll based program in the US, the workers' compensation system (WC) has evolved better over time because it incorporates flexibility for states to utilize various industry and regulatory structures. Workers' Compensation program evolution is just one example. Welfare (formerly AFDC) significantly benefitted from experimentation - - a number of states secured waivers and the most successful state experiments were later embodied in the 1996 federal reform that drove significant improvements in recipient individual and family outcomes. In short, the experience of varying state programs helped the entire country find a better way to help those on welfare move to employment and self-sufficiency.

Recrafting the UI system to provide states more flexibility would involve allowing states to offer innovative methods to find jobs for the short-term and long-term unemployed while preserving benefits to support them in the meantime.

This proposal recommends that the Congress enact legislation that could permit three demonstration options that would test alternate means of operating unemployment insurance systems, from the most comprehensive state-owned system, to two subsidiary concepts. Each of the three options presented below are state opt-in. Interested states would choose their demonstration option from among the three, and up to a maximum of seven states would be

permitted to opt in to each. This would yield a maximum of 21 potential simultaneous demonstrations (maximum of seven states times three options).

Option One. States to own and manage their own statewide UI system

In the most comprehensive of the three proposed options, States would create and manage their own statewide unemployment insurance systems consistent with proper purpose and protections. Such a program would be designed so as to be solvent over the long term and sufficiently funded to provide adequate insurance protection for the unemployed.

General Features under Option One

- The state owned system would retain the options currently available under the federal program, including determining level of benefits, maximum duration, and the obligations of workers to seek employment. States would have broad new authorities to determine the nature of the program and how it is funded, with some of the options as described below.
- A small portion of the current FUTA tax sufficient for Federal administrative purposes only would be allocated to the US Department of Labor. Remaining FUTA funds and all SUTA funds would be placed in state owned and managed trust funds.
- States would have the authority to fund the state trust fund as now through payroll taxes, and may use alternative or supplementary mechanisms.
- All recipients of unemployment benefits at the date of the change-over would remain in the existing program. New initial applicants would be covered under the new arrangement.
- States would retain the option of participating in special Federal funded extensions during periods of high unemployment under the same terms as states which have not opted in and remain in the Federal system.
- State UI loan balances owed to the Federal government would remain obligations as they are now.

Option Two. Expand reimbursing option to any employer within the state

This option would permit contributing employers to elect to be reimbursing employers under the same basic terms as under current law for non-profits and certain other entities. Once an employer elects to be a reimbursing employer, such designation could not be reversed for five years (to prevent gaming). The state would measure outcomes of the demonstration, including reports showing (a) the number of employers electing the option; (b) the duration of unemployment compensation of individuals who became unemployed; (c) the reemployment rate of individuals who became unemployed from pilot employer entities; (d) the average duration and reemployment rates of reimbursing vs. contributing employers in the state.

Option Three. Dedicated set aside of small portion of SUTA tax for targeted efforts

States could set aside up to 2% of its state unemployment tax revenue for use in administration of Reemployment Eligibility Assessments and reemployment services of claimants who are unemployed and not expecting to return to their job, as defined here:

The 2% funds could be used to pay for administrative costs associated with initiatives that reduce the duration of benefits, increase reemployment and reduce overpayments. Examples of interventions include targeted reemployment services, improved identification of fraud, and efficient collection of overpayments. Administrative funding would not be subject to “merit staffing” requirements of Section 303 of the Social Security Act.

WHAT ARE CHANGES STATES MIGHT INCORPORATE UNDER A STATE-DESIGNED UI SYSTEM (OPTION 1) ?

- *Active case management.* State unemployment offices which change their orientation so as to view their mission as putting people to work, as opposed to just paying out benefits, can have a sizeable impact. Texas has boosted by 50% the proportion of beneficiaries working in the tenth week after UI enrollment through a specific back to work orientation and goal measurement within its job service offices. Many states are experimenting with the federal grants for Reemployment Eligibility Assessment (REA) programs and seeing as much as a 400% return on investment in case management to help claimants return to work.

- *Temporary short-term work options.* Texas, Oregon and other states have had success offering a subsidy to employers to create new positions for unemployed individuals at the lower end of the experience and training scale, getting them working sooner.
- *Optional lump sum payments* At the outset of unemployment, these act as alternatives for workers who find new jobs quickly. The totals expended would be equal to or less than the anticipated drawdown for the duration of unemployment, based on state-designed profiles. Bonuses tested in four states were found to be effective at inducing re-employment.
- *Extending the “Reimbursing” option to self-insure, to all employers.* At present, nonprofit organizations, government agencies, and Indian tribes have this option. There is no reason this provision, which reduces costs to employers and the UI system, should not be extended to all private employers, with proper oversight and protection.

CONCLUSION: THE EXPECTED BENEFITS

The federally dominated UI system promises more benefits than it can deliver. A state owned and managed UI system will provide management and budget discipline. It can potentially bring in self-insurance as well as the insurance market to properly price and deliver benefits under a better alignment of interest between taxpayers and job seekers. Finally, it can provide dozens of separately designed and operated solutions to unemployment, enlightening national policy and encouraging change.

QUESTIONS AND ANSWERS:

General Question: Why are the number of demonstrations limited to 21 in the proposal?

There is no program reason to limit the maximum number of demonstrations. The limit of 21 was chosen as a way to communicate to Congress that these bold proposals are nevertheless finite experimental tests to help guide more comprehensive subsequent legislation. If, as was the case during the welfare experimental period in the 1990s, there is strong demand from states for still more demonstration opportunities, Congress can be expected to respond or even lift the proposed maximums altogether.

Q and A Option One. States to own and manage their own statewide UI system

In the most comprehensive of the four proposed options, States would create and manage their own statewide unemployment insurance systems consistent with proper purpose and protections. Such a program would be designed so as to be solvent over the long term and sufficiently funded to provide adequate insurance protection for the unemployed.

The state owned system would retain the options currently available under the federal program, including determining level of benefits, maximum duration, and the obligations of workers to seek employment. States would have broad new authorities to determine the nature of the program and how it is funded, with some of the options as described below.

A small portion of the current FUTA tax revenue would be allocated sufficient for Federal administrative purposes only. Remaining FUTA funds and all SUTA funds would be placed in state owned and managed trust funds.

Q: Why is this proposal needed?

Individual states vary considerably in tax base, industrial mix and methods that may be most effective in reducing the duration of unemployment, returning workers to work, and most efficiently and effectively using administrative funds.

In addition, state workforce agency resources for employment security administration are being systematically underfunded, particularly in the years after increased UI claims loads. While federal funding is inconsistent and insufficient, states and their employers are paying excess FUTA taxes as compared to returns.

Q: How would FUTA funds and all SUTA funds be placed in state-owned and -managed trust funds?

Simply put, SUTA payments would be retained in state managed custodial accounts instead of being transferred through Federal Reserve banks into the US Treasury. FUTA taxes would be collected by state UI tax administrators on a quarterly basis along with SUTA quarterly taxes and deposited into separate state custodial accounts. Each state would become an agent for the IRS for this specific purpose. Transition language and coordination would be needed with respect to funds held by the state.

States would have the authority to fund the state trust fund as now through payroll taxes, and may use alternative or supplementary mechanisms. All recipients of unemployment benefits at the date of the change-over would remain in the existing program. New initial applicants would be covered under the new arrangement.

States would retain the option of participating in Federal funded extensions during periods of high unemployment under the same terms as states which have not opted in and remain in the Federal system.

Q: How much of the current FUTA tax would be sufficient for federal administration?

Analysis made by DOL and OMB in 2001 (New Balance proposal) estimated that 2% of FUTA revenue would be sufficient to cover appropriation levels for the functions identified in Title IX of the Social Security Act (i.e. federal oversight of UI, UCFE, UCX, Vets Employment Services, Wagner Peyser, and BLS LMI). An update of the percentage is needed to assure appropriate funding levels.

Funding for the federal share of regular Extended Benefits (EB) should be more properly paid from federal general revenue, not from the FUTA tax, as this is contrary to its original intended use.

Q: Would this option result in shifting costs to other states not electing the option? Specifically, what if any impact would there be on the Federal Unemployment Trust Fund Extended Unemployment Compensation Account (EUC) which is used to fund the federal share of extended benefits? And the same question as it applies to the Federal Unemployment Account (FUA) used to provide loans to states to pay unemployment compensation through Title XII of the Social Security Act?

There would be no cost shifting to other states not electing Option One because there is no relationship between amounts in the EUC account and federal reimbursement of the federal share of extended benefits. Nor is there a relationship between the availability of Title XII loans and amounts showing as balances in the FUA account.

States not participating in Option One would not experience negative impacts on the federal share of extended benefits, nor the availability of loans through the FUA account. The effective source of these additional benefits under current law is federal general revenue, which would be otherwise unaffected by this proposal.

Q: Would states choosing Option One still be eligible to receive federal reimbursement for the federal share of extended benefits or other special distributions such as emergency unemployment compensation even though employers in the state may not have paid FUTA taxes that were credited to the EUC account?

Yes. Under current law there is no federal requirement that FUTA taxes must be paid as a condition of a state triggering on regular Extended Benefits. Federal law does not limit federal reimbursement to amounts available in the EUC account. Other special distributions would likewise not be limited.

Q: The National Association of State Workforce Agencies, the National Governors' Association, the Interstate Conference of Employment Security Agencies, and state legislators have advocated for federal law that would require a higher percentage of FUTA receipts to be dedicated for administration of employment security. How would option 1 affect such proposals?

Option One is consistent with advocacy for access to increased administrative funding and more flexibility in its effective use by states. To the extent that Option One pilot states demonstrate improved outcomes for individuals and return on investment for employers, its success would provide more support for the availability of additional funds at the state level with greater flexibility.

Q: How would Option One affect efforts to amend the current extended benefit trigger provisions of federal law to make them more targeted and meaningful and eliminate the need for special emergency unemployment compensation programs?

State participation in Option One would not negatively affect efforts to improve the current EB program, and the increased flexibility provided would enable the states to enact additional state extended and emergency unemployment compensation as needed in the state.

Q: Why is the access to special federal distributions needed?

Some states are more likely to trigger on to the existing permanent federal EB program and should not lose the availability of federal general funds by opting into this pilot. Pilot states would simply sign EB administration agreements to receive federal reimbursement, as is the practice now in some states.

Option Two. Expand the reimbursing option to any employer within the state

This option would permit contributing employers to elect to be reimbursing employers under the same basic terms as under current law for non-profits and certain other entities. Once an

employer elects to be a reimbursing employer, such designation could not be reversed for five years (to prevent gaming). The state would measure outcomes of the demonstration, including reports showing (a) the number of employers electing the option; (b) the duration of unemployment compensation of individuals who became unemployed; (c) the reemployment rate of individuals who became unemployed from pilot employer entities; (d) the average duration and reemployment rates of reimbursing vs. contributing employers in the state.

Q: Why is this option needed?

This option provides states and their employers with an alternative to better align benefit payments with contributions and reimbursements over time, improving the management of unemployment claims and spurring greater efforts to help laid off employees find new jobs.

In some states the relationship between the amounts paid in benefits and those collected via contribution rates to be paid have substantially diverged. Where this is present, the lack of a close connection between taxes paid by individual employers and benefits to their employees who have become unemployed lowers the priority they may place on helping unemployed claimants return to work.

Q: Would the exiting of reimbursing employers place stress on the state UI trust fund?

The pilot would enable a state to measure and determine whether the key metrics of duration of unemployment and return to work are positively influenced by a more direct relationship between employer costs and benefit payout. If so, this will improve the health of the system as a whole. A five year pilot should be sufficient time in which to evaluate these impacts.

There are many options states could use to assure the health of the state trust fund - - for example, restricting eligibility for the reimbursement option only to those employers with solvent individual unemployment account balances. Another state option is to require all employers, including reimbursing employers, to pay into the trust fund the socialized portion of the UI payroll tax, which has been estimated on average to be approximately \$34 per employee annually. To this could be added contributions to the trust fund in the amount of benefits charged to inactive employers, currently averaging \$21 (DOL August 2015).

Q: Would employers choosing the reimbursing option still be required to pay the FUTA tax?

Yes. One objective of the pilot is to better align the state unemployment compensation burden to the amounts an employer pays to cover these costs. The FUTA tax is designed to pay for certain other costs and is not experience rated.

Q. How would states mitigate the risk that contributing employers electing reimbursing would have insufficient funds to cover benefit payments after a large lay-off?

As with reimbursing employers generally, states may require surety bonds, letters of credit or other security to assure that benefit payments are reimbursed. The need for security has been recognized by states in the regulation of workers' compensation, where requirements for state approval as a self-insured employer typically limit qualifying employers to those that have the financial resources to assure payment or other measures such as adequate solvency.

Option Three. Dedicated set aside of small portion of SUTA tax for targeted efforts

Under this option a state could set aside up to 2% of its state unemployment tax revenue for use in administration of Reemployment Eligibility Assessments and reemployment services of claimants who are unemployed and not expecting to return to their job, as defined here:

- 1) Did not receive job referral through hiring halls established under collective bargaining agreements;
- 2) Has not received a specific return to work date from an employer; and
- 3) Is totally unemployed (i.e. not partially unemployed due to part time work, etc.).

The 2% funds could be used to pay for administrative costs associated with initiatives that reduce the duration of benefits, increase reemployment and reduce overpayments. Examples of interventions include targeted reemployment services, improved identification of fraud, and efficient collection of overpayments. Administrative funding would not be subject to "merit staffing" requirements of Section 303 of the Social Security Act.

Q: Why is this proposed option needed?

Federal funds currently provided for administration of employment security are insufficient, particularly for program integrity, systems support and assisting individuals in returning to work. Greater funding and flexibility in the use of administrative funding would better enable states to explore better methods of administration.

Q: Why does the proposal specify that the administrative funding would not be subject to “merit staffing” requirements of Section 303 of the Social Security Act?

States could elect to use state-based merit staffing in hiring staff but would not be federally required to do so. Under this provision states would be permitted to contract for services to be provided.

As a pilot, the proposal seeks not to disrupt the regular administrative structure, but to enhance flexibility in the use of a targeted stream of funds. We also don’t want the availability of special pilot funding to be noted as a reason for Appropriators in Congress to further reduce administrative funding.

Q: Why is the amount to be set aside limited up to 2% of SUTA?

The 2% is suggested as a limit in recognition of the need to assure that the primary purpose of the SUTA tax is to generate revenue to pay benefits. At 2% the amount generated would be sufficient for pilot approaches that focus on a subset of claims to assist in returning to work and assuring integrity that may provide models for expansion.

Separate funds for REA and related RES services are already being provided through the federal appropriation process. This 2% would be in addition to funds otherwise appropriated.

Q: How would the “up to 2%” be determined and made available?

Legislation would enable pilot states to transfer up to 2% of the amount of SUTA revenue deposited into the state’s unemployment benefit account for the most recently completed four quarter period prior to the beginning of the federal fiscal year on October 1st into a Reed Act like account that may be used as specified within the pilot guidelines. Funds not used for administration during the pilot period would be retained to pay for benefits.