

XI. Unemployment Insurance Benefits and Financing During the Great Recession

UI Trust Fund Solvency: Analysis from 1979–2010

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The federal–state unemployment insurance (UI) program provides temporary assistance to unemployed workers by replacing a portion of lost wages. States maintain reserves, funded through employer taxes, in trust funds, out of which they pay UI benefits. However, the severity and length of the recent recession, and the slow pace of recovery, have placed a heavy demand on state UI trust funds, and the large majority of states have needed loans from the federal government to continue to pay benefits. Continued high unemployment has put the UI program in historically poor financial condition.

However, concerns over the adequacy of UI trust fund levels are not new to the current and recent economic downturn. For the last three decades, and particularly during prior recessions, there has been concern that some states were not sufficiently funding their programs. Two national commissions, one in the early 1980s and the other in the mid-1990s, have examined UI financing, as did GAO in 1988, 1990, and 1993. Each of these studies raised concerns that long-term state practices in UI financing have been insufficient to fulfill the goals of the UI program—to ease individual financial hardship and stabilize the economy in periods of unemployment.

This paper highlights long-term policies or practices that have contributed to their condition, and identifies options for improving UI forward funding in the future.¹

Background

The primary objectives of UI are to provide temporary, partial compensation for lost earnings of individuals who become unemployed through no fault of their own, with some exceptions, and to stabilize the economy during economic downturns.² Federal law sets forth broad coverage provisions for the categories of workers who must be covered by the program, some benefit provisions, the federal tax base and rate, and administrative requirements, such as how states will repay UI trust fund loans. Within the framework established by federal law, states can determine key elements of their UI programs, such as eligibility/disqualification provisions, the benefit amount, and the amount of taxes that employers must pay.

The UI program was designed to be forward funded and self-financed by states, with each trust fund building up reserves from employer taxes during periods of economic expansion in order to pay UI benefits during economic downturns. Because unemployment can vary substantially during a business cycle, it is important that states build sufficient trust funds to remain solvent during recessionary times. The program is financed primarily by taxes levied on employers.³ Each state sets UI tax rates to finance regular UI benefits. In addition, employers pay a Federal Unemployment Tax Act (FUTA) tax. The FUTA tax on employers is 6.2% on the first \$7,000 of each employee’s annual pay.⁴ Employers in states whose UI programs comply with federal requirements receive a tax rate credit of 5.4%, resulting in an effective rate as low as 0.8%, or a

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maximum of \$56 per worker per year.⁵ The FUTA tax is used to fund (1) federal and state UI administration costs;⁶ (2) the federal share of extended benefits (EB); (3) Title XII loans to state trust funds when they cannot pay benefits;⁷ (4) benefits under federal supplemental and emergency programs; (5) labor exchange services,⁸ employment, and training for veterans; and (6) some labor market information programs.

States choose both a taxable wage base (the annual earnings per worker on which employers pay UI taxes) and statutory tax rates that apply to the base. In order for employers in their state to qualify for the full FUTA tax credit, each state’s taxable wage base must at least equal the FUTA wage base (currently \$7,000, the level since 1983), and statutory rates must be experience rated—that is, varying with an employer’s layoff record. Experience ratings provide reduced rates for employers with fewer layoffs and increased rates for those with more layoffs. Tax rate assignment may include “socialized” costs that are not charged to individual employers, such as costs of benefits to employees of firms that went out of business but did not have sufficient reserves to pay UI taxes or benefits that are charged to a specific employer but are not fully recovered from that firm in tax revenue.⁹

The Unemployment Insurance Trust Fund (UTF) in the U.S. Treasury consists of 53 state accounts, including one each for the District of Columbia, the Virgin Islands, and Puerto Rico, plus six federal accounts that are dedicated for special purposes. Federal taxes go into the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA) and the Federal Unemployment Account (FUA), and state taxes go into their individual state accounts (Table 1).

TABLE 1
Summary of Major UI Federal Accounts

Name	Description
Employment Security Administration Account (ESAA)	Finances administration of the state UI and employment services (ES) programs.
Extended Unemployment Compensation Account (EUCA)	Reimburses states for the federal share of extended benefits. Permanent extended benefits program provides up to 13 weeks of additional UI benefits.
The Federal Unemployment Account (FUA)	Provides loans to insolvent state trust funds.
The Federal Employees Compensation Account (FECA)	Finances benefit payments to former federal and military employees

Source: Department of Labor, Employment and Training Administration (ETA).

Note: In addition, there are two accounts related to the Railroad Retirement Board that pay UI benefits to railroad workers, the only occupational group covered under a separate UI system. They are financed by railroad contributions and administered by the Railroad Retirement Board.

When the ESAA, EUCA, and FUA accounts reach prescribed statutory ceilings, the excess funds are transferred to individual state accounts under the Reed Act.⁹ DOL bases each state’s share of Reed Act funds on the state’s proportional share of FUTA taxable wages. Federal law restricts states to use Reed Act¹⁰ distributions, the mechanism by which the federal government gives surplus cash back to states, only to cover the cost of state benefits and administration of state UI and ES programs. A state must have a specific appropriation from its legislature in order to use its share of the Reed Act funds for administrative expenses.¹¹ There have been eight Reed Act distributions since 1956, most recently in 2002; the Congress has raised the Reed Act’s statutory ceilings that trigger the distribution of the surplus funds several times.¹²

Almost all states measure their trust fund balances and make tax rate changes once per year.¹³ The majority of states have trust fund balance targets written into their state law, with triggers built in to adjust the tax rates according to the state’s trust fund balance. According to DOL, most states impose higher tax rates when their UI balances are low and lower rates when their balances are high. Nearly half of states with targets base them on a percentage of their payrolls or specific dollar amounts. For example, New York requires the equivalent of at least 5% of its annual payrolls in its trust fund to enact its lowest tax schedule; the highest schedule applies when the trust fund is less than 0% of the payroll. Other states have trust fund targets that are based on other measurements of trust fund levels, such as state-determined experience or adjustment factors, and some states do not have specific UI trust fund goals in their laws. For example, 4 of the 53 states

have laws that authorize their labor agencies to set the tax rates. State trust funds are credited with interest on their balances.

As UI is forward-funded, states collect trust fund reserves in advance to pay benefits. However, during exceptional periods when states exhaust their UI reserves, they may borrow from the federal government. States can, under certain conditions, borrow interest free, as long as the loan is repaid by September 30 of the year of the loan (a “cash flow” loan).¹⁴ If a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid by November 10 of the second year, or employers in that state lose 0.3% of the FUTA tax credit each year there is an unpaid balance. For example, if a state borrows to pay UI benefits and has an outstanding loan balance on the second subsequent January 1, the FUTA tax credit falls from 5.4% to 5.1%, and employers’ effective FUTA rate jumps from 0.8% to 1.1%. However, states with outstanding loans can still seek relief from these loan provisions. If state trust funds meet specific requirements, such as not taking any action during the previous year that would diminish the solvency of their trust fund, the reduction in the FUTA credit may be capped.¹⁵ States that have an average total unemployment rate of 13.5% or more¹⁶ can also delay payment of interest for a grace period of up to nine months.¹⁷ Some states have also chosen to secure loans in the private bond market, using the proceeds from private loans to repay borrowing from the federal government, and then levying higher payroll taxes on employers in subsequent years to repay the private loans.

Measures of UI Solvency

Measures of UI solvency are expressed as a percentage of wages, typically total annual wages earned by employees who are potentially eligible for receiving UI benefits (or “UI-covered wages”).¹⁸ ETA reports reserve ratios, or UI trust fund levels, as a percentage of total annual statewide wages, as well as a high cost multiple (HCM), which divides the reserve ratio by the high cost rate, the highest historical ratio of benefits to wages for a 12-month period in that state. An HCM of 1.0 corresponds to sufficient reserves to pay benefits at the high cost rate for one year. A similar measure is the average high cost multiple (AHCM), which divides a trust fund’s reserve ratio by the average high cost rate, which is the average of the three highest calendar-year benefit cost rates in the last 20 years or in the period covering the last three recessions, if longer. An AHCM of 1.0 is the target level of solvency recommended by the Advisory Council on Unemployment Compensation and is inherent in DOL’s draft regulations on cash-flow loans.

State UI Trust Funds Are at Historically Weak Levels, with Most Requiring Federal Loans to Pay Benefits

By any measure, UI trust funds nationwide are in historically poor financial condition. Aggregate net reserves (reserves less loans) as of the end of the third quarter of 2010 measured approximately –\$27 billion, the lowest level in nominal or real terms in the program’s history. As of December 21, 2010, 31 state trust funds had taken out federal loans totaling \$40.4 billion. By comparison, 24 states required loans during the recession of the early 1980s, during which unemployment nationally approached 11%. As of the third quarter of 2010, no state had an HCM as high as 1.0 (which would indicate sufficient reserves to pay benefits at historically high rates for 12 months), and only 11 states had reserves of at least 1% of wages.

The recent recession and ongoing weak labor market recovery have resulted in very large numbers of workers receiving benefits for very long periods of time. The insured unemployment rate (IUR), which provides a measure of the percentage of the UI-covered labor force receiving benefits, reached 4.6% in the second quarter of 2009, higher than any annual level since reaching 4.7% for 1982.¹⁹ Despite continued high unemployment, the average IUR dropped to 3.6% by the second quarter of 2010—most likely reflecting the 53.8% of claimants exhausting benefits, thus removing from the IUR numerator. Unemployed workers have also experienced an historically long duration of benefit reciprocity during this recession. Nationally, the average duration among those workers receiving benefits during the second quarter of 2010 was 20.0 weeks, higher than any annual average in the program’s history.²⁰

As a result of the severe drain on UI reserves, UI taxes in most states increased in 2010 because of automatic triggers in most states. Twenty-five states raised their UI taxable wage base in 2010, including nine

that do not index the base to average wages. Despite projected tax increases in many states, UI reserves are expected to decline at least for the next two years, barring an unexpectedly sharp recovery in the labor markets.

Long-Standing State UI Policies and Practices Have Led to Trust Fund Vulnerability

While the recent recession has severely drained UI reserves, the current situation reflects long-term financial decline. UI reform, particularly with respect to financing the program, has been a long-standing (albeit sporadic) policy concern for the federal government, state workforce agencies that administer the program, and advocacy organizations. A 1980 national commission expressed concerns about the “financial footing” of the program,²¹ while a 1988 GAO report raised questions about the effect of long-term UI financing inadequacy on future benefit eligibility.²² A 1988 study of the program by the Congressional Research Service highlighted the problem of insufficient financing.²³ In addition, a 1993 GAO report found that the ability of the UI program to stabilize the economy had diminished,²⁴ and a Presidential commission (the 1994–1996 Advisory Council on Unemployment Compensation) called for a stronger role for the federal government to promote UI forward funding.²⁵

The mid-1970s marked a noticeable shift in trust fund financial conditions, starting with the recession that lasted from 1973 to 1975. Prior to that time, from 1938 to 1973, state UI trust funds held average year-end reserves, net of loans, equal to 5.1% of wages, and never dropped below 2%. From 1974 to 2008, that average fell to 1.0% of wages and has never been as high as 2%. Therefore, states have had less of a financial buffer in their trust funds to withstand a high-cost benefit period. Prior to the recent recession, the aggregate HCM nationwide was only 0.35, corresponding to enough reserves for about four months of benefits at a high-cost rate; therefore, even a much milder recession was likely to have caused widespread trust fund insolvency. Further, Table 2 shows a large difference in the average HCM prior to the current recession for states that have needed to borrow to pay benefits (average HCM of 0.32) and those that have not (0.87), with similar pre-recession funding differences for the three previous recessions.²⁶ This suggests that pre-recession funding levels have played a key role in helping states avoid loans during the recent recession and current recovery (although the average peak IUR in borrowing states has also exceeded that of non-borrowing states). Further, average U.S. pre-recession funding levels were lower prior to the recent recession than for the previous three. Perhaps most surprising is that despite a ten-year economic expansion prior to the 2001 recession, states built up trust funds to an average HCM of only 0.64, enough to pay benefits at a high-cost rate for about eight months.

TABLE 2
Key Trust Fund and Employment Statistics for Last Four U.S. Recessions

Date of recession	2007		Early 1980s		1990		2001	
	Pre-recession HCM	Peak IUR	Pre-recession HCM	Peak IUR	Pre-recession HCM	Peak IUR	Pre-recession HCM	Peak IUR
States taking out federal loans (number of states)	0.34 (34)	4.9	0.28 (25)	5.2	0.34 (5)	3.7	0.30 (5)	2.7
Non-borrowing states	0.93	4.2	0.96	4.6	1.01	3.1	0.91	2.7
All U.S.	0.35	4.6	0.41	4.7	0.86	3.2	0.64	2.8

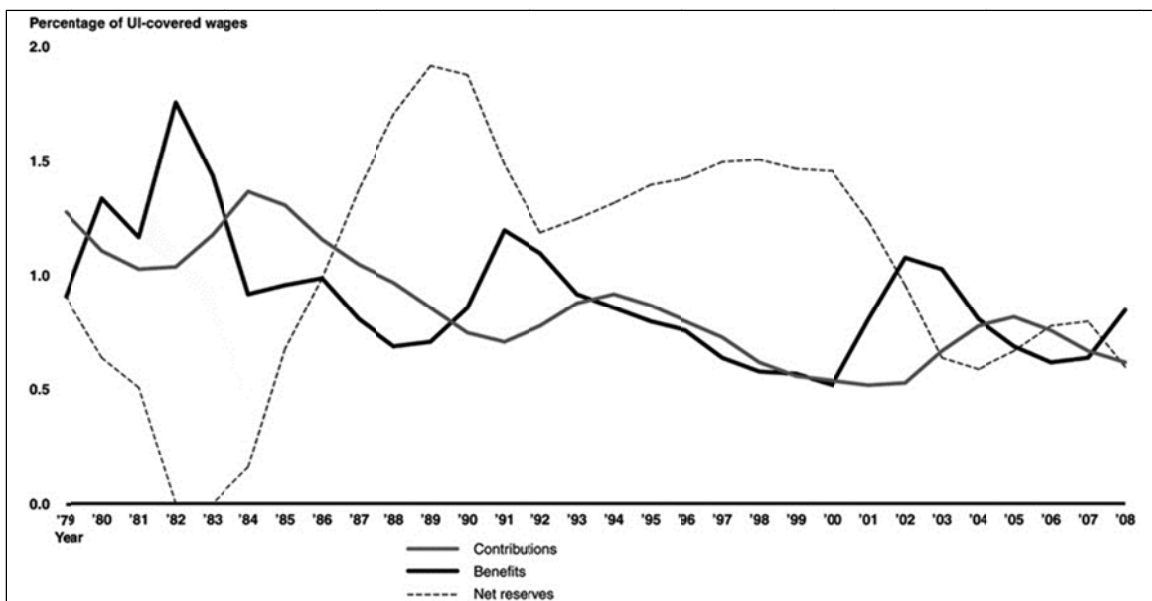
Source: Author calculations, based on Unemployment Insurance Financial Data Handbook, ETA.

Note: HCM is average state high-cost multiple just prior to recession, and IUR is average peak state insured unemployment rate following onset of recession (annual data for 1980s and 1990, quarterly for 2001 and 2007). “All U.S.” is not an average of state measures.

UI Taxation Levels Have Declined Since the 1970s

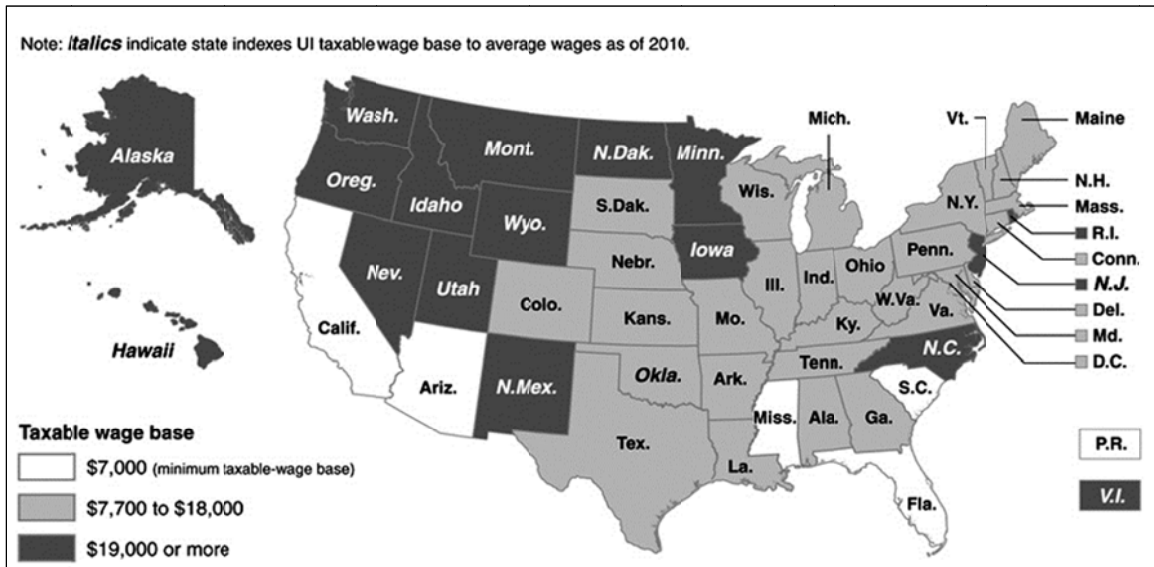
Declining UI trust fund reserves in recent decades suggest that states have reduced UI tax contribution levels, increased or broadened benefits, or both, although most of the evidence suggests that many states have reduced tax levels gradually. Although there are fluctuations, UI tax contributions as a percentage of UI-covered wages have trended downward in recent decades, from an annual national average of 1.15% (1979 to 1988) to 0.79% (1989 to 1998) and in the past decade to 0.65% (1999 to 2008) (Figure 1). Contribution rates exceeded 1.0% of total wages for each year from 1979 to 1987 but have fallen below that level each year since. Over the same 30-year period, average annual benefits slightly exceeded contributions, with benefits averaging 0.90% of annual wages and contributions averaging 0.86% of wages. Year-end net trust fund reserves over the period fell from 0.91% of wages in 1979 to 0.60% in 2008, with further declines in 2009. While there were expected fluctuations around the business cycles, with benefits surging during recessions and contributions rising when the economy strengthens, there has been a general downward trend in contribution rates over the period.

FIGURE 1
UI Contributions, Benefits, and Net Reserves, 1979–2008



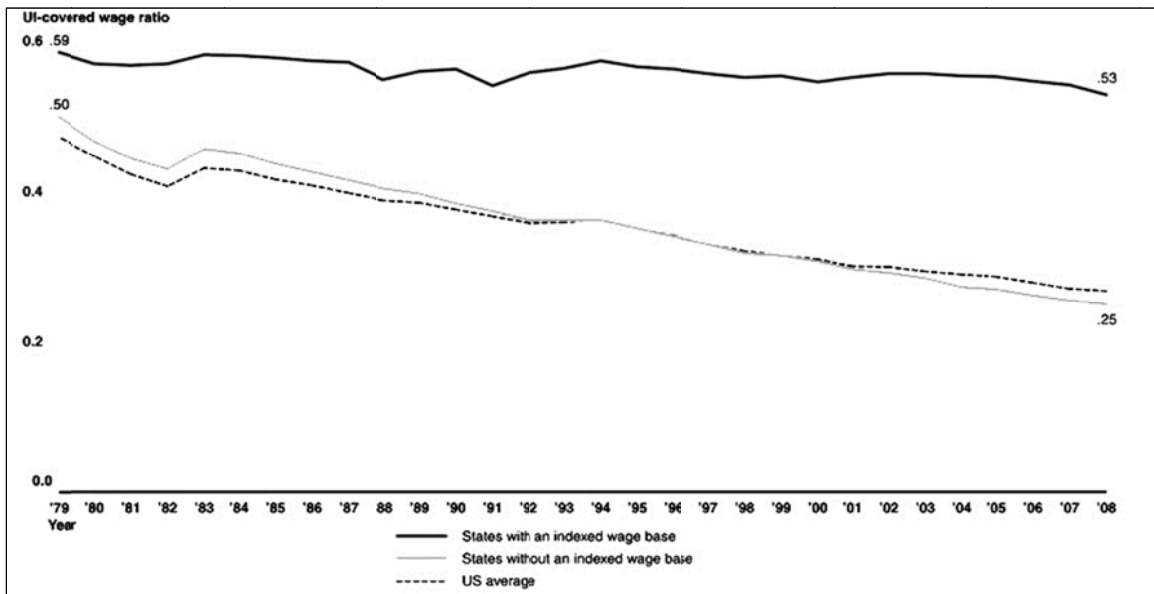
Eroding taxable wage bases. One key reason for falling UI contribution rates is that most states do not index their taxable wage bases, the annual earnings per employee on which employers pay UI taxes, to average wages. As of 2010, only 17 of the 53 state trust funds have taxable wage bases that are indexed to average wages (Figure 2).²⁷ In contrast, other states change their wage bases sporadically or very infrequently. Twenty-six have UI taxable wage bases of \$10,000 per worker per year or less, including six that have set theirs at the FUTA wage base level of \$7,000 since it last changed in 1983. As a result, employers pay taxes on a gradually shrinking portion of total wages as wages have risen since then. The ratio of UI-taxable to total wages measured 47.2% in 1979 but has declined steadily since then, measuring 26.8% in 2008. States not indexing their wage bases account for most of this decline—the ratio in these states fell from 0.50 to 0.25 over this period while indexing states' average ratio dropped only from 0.59 to 0.53 (Figure 3).

FIGURE 2
UI Taxable Wage Bases, 2010



Note: Each state's taxable wage base is the annual earnings per employee on which employers pay UI taxes. For other major characteristics of state UI programs, see Appendix 3.

FIGURE 3
Comparison of UI-Taxable/Total Wage Ratio, States
with Indexed Taxable Wage Bases vs. Other States, 1979–2008



Note: The UI-taxable/total wage ratio divides the portion of total wages among employees in UI-covered employment each state subjects to UI taxation by the total wages earned by these employees. Some states have indexed their UI taxable wage bases for only some years during 1979–2008. We categorize Virgin Islands as indexing from 2004–2008; Rhode Island from 1980–1998; Wyoming from 1984–2008; Oklahoma from 1986–2008; and North Carolina from 1984–2008. States that indexed their wage bases for the entire period are Alaska, Hawaii, Idaho, Iowa, Minnesota, Montana, Nevada, New Jersey, New Mexico, North Dakota, Oregon, Utah, and Washington.

A comparison of financial measures for states that index their UI taxable wage bases and those that do not reveals that indexing states have maintained higher annual average reserve ratios and had many fewer instances of trust fund insolvency, even accounting for the smaller number of states that index (Table 3). In indexing states, employers pay higher contribution rates—paying, on average, lower tax rates on higher tax bases. Benefits in indexing states, as a percentage of annual wages, also exceed those in non-indexing states. Finally, states currently indexing their taxable wage bases have higher trust fund reserve ratios (as of third quarter 2009), although 6 of 17 indexing states currently have outstanding loans (as opposed to those in 25 of the 36 non-indexing states).

TABLE 3
UI Financial Statistics, States with Indexed Taxable Wage Bases vs. Other States, 1979–2008

	Avg. taxable wage base (\$/worker/yr)	2010 avg. taxable wage base (\$/worker/yr)	Taxable wages (% of UI-covered wages)	Net reserves (% of UI-covered wages)	Instances of states receiving federal UI loans ^b	UI contributions (% of UI-covered wages)	Tax rate (% of taxable wage base)	Benefits (% of UI-covered wages)	Trust fund balance as of 4th quarter 2009 (% of UI-covered wages)
Indexing states (17, as of 2010) ^a	\$16,112	\$27,218	56.1	2.12	11	1.11	1.96	1.09	1.05
Non-indexing states (36) ^b	\$8,016	\$9,742	36.1	1.44	55	0.84	2.30	0.87	0.37

Source: Author calculations using data from Unemployment Insurance Financial Data Handbook, ETA.

Note: Figures are annual averages for 1979–2008 except as noted.

^aSee note in Figure 4 about states that have indexed their taxable wage base for part of this sample period.

^bCounts the number of states that had an end-of-year UI loan balance from the federal government during or following each of the four recessions occurring from 1979 to 2008, with consecutive multi-year balances during one recession or recovery counting as one event.

Low state UI tax rates. While taxable wage bases have eroded in most states over the last 30 years, the tax rates employers pay on these bases have not offset this decline, according to analysis by the Urban Institute. Table 4 illustrates how minimum tax rates have generally trended downward, while maximums have moved up during the last 30 years. From 1978 to 2008, average minimum tax rates levied on employers by states dropped from 1.14% to 0.37% of taxable wages. State minimum rates generally moved downward, with the number of states with a minimum rate of zero rose from three to nine. The average maximum rate increased from 4.44% of taxable wages in 1978 to 7.06% in 2008, but most of this jump occurred following a 1982 statutory change raising the state maximum rate required to qualify for the FUTA tax credit from at least 2.7% to at least 5.4% of taxable wages—since 1988, average maximum tax rates have remained near 7.0% while average minimum rates have fallen by half.²⁸ Maximum statutory tax rates in 2009 ranged greatly across states, from 5.4% of taxable wages per employee in 16 states to 13.2% in Pennsylvania.²⁹ Overall, UI statutory tax rates applied to wage bases averaged 2.7% of taxable wages from 1979 to 1988, then 2.2% from 1989 to 1998 and again from 1999 to 2008.

Further, average tax rates on total wages in many states have fallen below what DOL considers to be adequate to cover the costs of benefits.³⁰ A 2009 DOL report on state tax systems reported that all but six states levied average tax rates below the rate adequate to cover benefits and maintain solvency.³¹ Similarly, only seven states met their adequate financing rates in 2008; states were better at meeting their adequate financing rates in 2006 and 2007.³² As of 2009, 20 of 43 states and territories that submitted information for a 2009 DOL report on state tax systems had trust funds with minimum tax rates that were less than \$15 per

employee per year, and 12 of these states had a minimum tax rate of zero. In 34 of these 43 states, over half of the employers paid UI tax rates of 0.5% or less of total wages, while nationally in the aggregate, 67% of U.S. employers paid this low rate. In 30 states, as well as the United States overall, this low rate was applied to at least half of the total UI-eligible wages. The United States as a whole had only 3% of its employers paying taxes greater than 2% of total wages.

TABLE 4
Distribution of Minimum and Maximum Statutory UI Tax Rates by State, 1978 to 2008

Year	Number of states with minimum tax rates of:								Average minimum rate
	0	0.01 to 0.29%	0.3 to 0.69%	0.7 to 1.09%	1.1 to 1.59%	1.6 to 2.09%	2.1 to 2.59%	2.6% and above	
1978	3	9	11	4	10	2	3	9	1.14
1988	4	11	14	7	7	6	2	0	0.74
1998	8	19	13	2	4	4	1	0	0.50
2008	9	19	14	3	5	1	0	0	0.37

Year	Number of states with maximum tax rates of:								Average maximum rate
	2.7%	2.71 to 4.0%	4.01 to 5.39%	5.4%	5.41 to 6.49%	6.5 to 7.49%	7.5 to 9.09%	9.1% and above	
1978	4	20	16	1	6	2	2	0	4.44
1988	0	0	0	17	9	5	11	9	6.99
1998	0	0	0	16	10	8	12	5	6.82
2008	0	0	0	17	10	5	8	11	7.06

Source: Urban Institute analysis of ETA “Significant Provisions of State UI Laws,” and “Comparison of State Unemployment Insurance Laws,” various issues. State averages are simple averages of 51 programs that weight each state equally regardless of size. Data exclude Puerto Rico and the Virgin Islands.

Benefits Have Remained Fairly Flat in Recent Decades

By several measures, UI benefits have remained relatively flat or declined in recent decades, suggesting that declining trust fund reserves cannot be explained by a significant change in benefits. Aggregate annual benefits nationwide averaged 1.10% of UI-covered wages from 1979 to 1988, then dropped 0.84% from 1989 to 1998 and again to 0.76% from 1999 to 2008. Average weekly benefits paid as a percentage of average weekly wages have remained relatively flat from 1979 to 2008, fluctuating from approximately 33% to 38%. Measured in terms of replacement rates, or the ratio of individual benefits received to prior wages, benefits to wages have also remained fairly flat from 1988 to 2007, ranging from 44% to 47%. Moreover, as we found in 2007, the UI recipiency rate, which effectively measures the percentage of the unemployed who receive benefits, gradually declined from the 1950s through the 1980s and remains below the near-50% rate of the 1950s. In 1979, the ratio of the insured unemployment rate to the total unemployment rate measured 48%, compared to 43% in 2008.³³ Further, low-wage and part-time workers continue to experience low rates of benefit receipt.³⁴ For example, we found that low-wage workers were more than twice as likely to be unemployed, but about half as likely to receive UI benefits.³⁵ We have also found that past declines in the percentage of unemployed who receive UI benefits are associated with declines in state UI trust fund financial condition. For example, in 1993 we found that if the same proportion of unemployed workers had received comparable benefit payments during the 1990–1991 recessionary period as during the 1974–1975 recession, about \$20 billion more in unemployment benefits would have been available to stabilize the economy and maintain the incomes of the unemployed. In addition, we found that states with declining or insolvent trust funds were likely to make it more difficult for unemployed workers to qualify for benefits and to reduce the portion of wages of former workers replaced by unemployment benefits.³⁶

States Annually Adjust Tax Rates Based on Trust Fund Levels

Currently, all states adjust UI tax rates yearly, based on an annual measurement of the size of the trust fund and calculation of employer experience rating. Generally, states raise UI tax rates as the trust fund diminishes in order to try to replenish the fund and lower them when the fund grows to a certain level. This practice has the advantage of providing automatic stabilization to UI funding. However, it creates two problems. First, annual adjustments might allow rates to remain inappropriately high or low for up to an entire year if economic conditions change sharply soon after the “fund trigger date” on which a state measures its trust fund. Some states told us that this occurred during the recent recession, which began in late 2007, and worsened in fall 2008 following the financial meltdown, right after some states had measured their trust funds. If states adjusted their tax rates more frequently, employers may have seen more gradual rate increases instead of the widespread sharp increases going into effect in 2010. Second, tying tax rates to trust fund conditions means that states are likely to raise taxes on employers when economic and labor market conditions are weak (coinciding with increased benefit payouts and low trust funds). Higher taxes during weak economic times may exacerbate labor market conditions (since higher UI taxes make it more expensive to hire workers) and economic recovery in general. Thus, the effects of state tax adjustments erode at least some of the stabilizing macroeconomic effects of paying UI benefits.

Among Policy Options, Revenue-Related Reforms May Hold Key to Improving UI Trust Fund Solvency

Given the UI program’s vision for economic stabilization through business cycles, it has been a policy goal for at least three decades to promote greater forward funding of the individual state funds. In 1980 and 1994, national commissions issued many recommendations for increasing and stabilizing program funding. These commissions, as well as other studies, have encouraged states to build up reserves and reduce the dependence on borrowing during difficult economic times. Table 5 lists some policy options for improving long-term trust fund financing with some of their advantages and disadvantages, based on our current findings.

TABLE 5
Policy Options for Improving UI Funding

Policy	Who could implement	Advantages	Disadvantages
Raise and index FUTA taxable wage base	Congress	<p>Would reverse years of erosion of UI tax base and maintain wage base as a consistent proportion of income.</p> <p>Would cause states to raise their taxable wage bases to qualify for FUTA credit.</p> <p>Could allow federal government and states to reduce statutory tax rates for given UI funding goals.</p>	<p>Higher UI taxes could discourage hiring.</p> <p>Federal taxable wage base represents different tax burdens to different states.</p> <p>Resistance of states to increasing burden on employers to pay more to federal trust funds.</p>
Reduce number of employers paying very low UI tax rates	States ^a	<p>Would increase UI contributions.</p> <p>Would better distribute costs of social insurance.</p>	<p>Fairness—UI taxes might not reflect costs attributable to employers.</p> <p>Would reduce incentive for employers to avoid layoffs.</p>
Reduce large tax subsidies across employers and industries	States ^a	<p>Distribution of UI taxes based on costs created by employer layoffs.</p> <p>Stronger incentives for employers to avoid layoffs.</p>	<p>Increased rates may encourage employers with high tax rates to try to circumvent tax.</p>

Table 5 continues, next page

Policy	Who could implement	Advantages	Disadvantages
Adjust state tax rates more frequently than annually and raise solvency targets before implementing lower tax rates	States ^a	Tax rates could adjust before trust fund becomes severely depleted. More funds raised during strong, not weak, economic conditions.	Higher administrative costs. Less ability of employers to anticipate tax rates. Resistance from employers to paying relatively high UI taxes when trust funds were flush.
Set additional conditions on interest-free loans	Department of Labor ^b	Strengthen incentives for states to avoid loans with more robust forward funding.	Increased reliance on higher tax rates during difficult economic times. Estimated small impact. State objections to paying more for funds their taxes provide.
Offer increased interest credits to state trust funds funded above a certain level	Congress	Incentive for states to save more in trust funds.	States with lower funding balances may receive less in interest.

Source: Author analysis based on findings.

^a While only states could implement these policy changes, Congress could include these as requirements for employers in a state to qualify for the FUTA tax credit.

^b Labor has published proposed rules on interest-free loan conditions that have yet to be finalized. See footnotes 20 and 51 for additional information on this proposed rule.

Raise and index FUTA taxable wage base. The FUTA taxable wage base has remained fixed at \$7,000 per worker per year since 1983.³⁷ Six state trust funds have also kept their taxable wage base at that level since then, while an additional 20 set theirs between \$7,000 and \$10,000. From 1983 to 2008, the average weekly wage in UI-covered employment rose from \$336 to \$869 per worker, a rise of 159%. By keeping the wage base fixed instead of rising with wages, the percentage of wages subject to UI taxation has fallen from 43.1% in 1983 to 26.8% in 2008. This means that a steadily shrinking portion of the wage distribution is responsible for raising UI revenues. This also suggests that any impact UI taxes have on reducing wages has been increasingly borne increasingly by lower-income workers. Raising the FUTA base to make up for some of the relative erosion in the UI revenue base and indexing it to future wage growth would ensure that a more constant share of total income supports the UI program. If the FUTA taxable wage base had risen roughly with the changes in wages since 1983, the 2008 taxable wage would be approximately \$18,100—higher than the 2010 tax bases for all but 17 state trust funds.³⁸ Since employers in states with tax bases that are less than the FUTA tax base would not be eligible for the full tax credit, states would almost certainly raise and index theirs to the new, higher FUTA tax base. The one-time increase and indexing of the taxable wage base would mean that state UI tax revenue would more likely represent a consistent share of total wages, as well as spread the effective tax incidence of UI taxes across more of the wage distribution. It would also allow states to set lower tax rates in order to raise a given amount of revenue, which is generally a more efficient way to tax than to set higher tax rates on a narrower tax base.

Most state UI program officials we interviewed said they would welcome, or at least accept, a higher FUTA taxable wage base, some emphasizing that some states have not been able to raise taxable wage bases on their own. Other representatives said they would object to higher federal UI taxes, some citing instances when the federal government raised the statutory ceiling that triggers a Reed Act distribution, thus postponing the payment of money to state trust funds. Higher UI taxes, by making employment somewhat more expensive, could discourage some employers from hiring; however, the federal government could lower the effective 0.8% tax rate states have paid since 1985, which would reduce the impact of raising and indexing the FUTA tax base.

Reform UI tax rates structure. Another set of policy options would involve adjusting the UI tax rates employers pay. For example, states could act to (1) reduce the number of employers paying very low UI tax rates, (2) reduce large subsidies among employers and industries that pay less in UI taxes than benefits paid to their former workers, (3) adjust tax rates more frequently, and (4) set taxes to raise more funds during strong economic times. The first option would widen the effective revenue base for the program by getting contributions from more employers and allow the state to reduce tax rates for the higher levels of the tax schedule. There are distinct arguments in favor of, and against, setting minimum tax rates for all employers, and experience rating in general. Assigning higher tax rates to employers who lay more workers off distributes program costs in an arguably fair way and creates an incentive for employers to retain workers during difficult economic times. On the other hand, all employers, even those without a history of layoffs, face uncertainty about the future UI claims of their employees, an argument for every employer paying to cover this social insurance.

As a second option, states could adjust experience ratings to reduce significant subsidies for some employers and industries. GAO reported in 2006 that industries with more seasonal layoffs, such as construction and agriculture, tend to pay less in UI contributions than their workers receive in benefits.³⁹ Such experience rating reform could raise additional revenues from high-layoff employers whose tax rates hit tax rate maximums, better distribute the UI tax burden to those employers who create higher benefit costs through layoffs, and reduce benefit costs to the extent that higher tax rates discourage these employers from laying workers off in the first place. On the other hand, raising the rates charged to employers with the highest experience rating might create strong incentives for firms to circumvent paying UI taxes.⁴⁰

A third option would encourage states to adjust UI tax rates more frequently if trust fund conditions change significantly and to raise more revenues when economic conditions are stronger. Annual adjustments to tax rates can lead to sharp increases when labor markets are weak. More frequent, even twice-yearly, measurement of trust fund conditions and tax rate adjustments could allow employers to absorb changes in tax burden more gradually. However, more frequent tax adjustments could create more administrative costs to implement, and employers may not like the increased uncertainty caused by more frequent tax adjustments. In order to build up more of a funding cushion when economic conditions are strong rather than when they are weak, states could consider setting higher trust fund targets before lowering tax rates. However, this would require employers tolerating higher UI tax rates than under the current system when trust funds are relatively flush.

Set additional loan conditions while increasing credits on trust fund balances. Recent proposed rules by the Department of Labor would seek to define eligibility for interest-free terms on federal UI loans by setting standards states would have to meet for maintaining the levels of their trust funds or a level of tax “effort” in the years prior to applying for a loan.⁴¹ While loans clearly serve a vital function in financing benefits during difficult economic times, they somewhat reduce the incentive for states to maintain robust trust funds. Stricter interest-free loan qualifications might encourage states to maintain higher funding targets, although Labor estimates such effects to be small. However, reducing access to interest-free loans could lead states to rely more heavily on raising tax rates when UI trust funds fall close to zero, which likely coincides with difficult economic periods when labor markets might benefit from lower, not higher, taxes. States may object to being charged more to take out loans, particularly during a recession as severe as the most recent one; in interviews, some state representatives expressed a sentiment that because the states fund the federal trust funds that provide loans when states need them, they should be available interest free. At the same time that rules could restrict interest-free loans, paying higher rates of interest on trust fund balances above a certain level (say, on balances corresponding to an AHCM of 1.0 or higher) could provide a positive incentive for states to accumulate more in UI reserves; for a given amount of interest, this would mean that states with lower funding levels would receive lower rates of interest.

Conclusions

Like UI funding itself, interest in the financial condition of state UI trust funds seems to follow the business cycle: during recessions that drain reserves and force states to borrow to pay benefits, UI stakeholders focus on the potential to improve forward funding in the future. But when the economy, and

with it trust fund levels, recovers, the urgency to do so subsides. As it stands today, the long-term decline of UI funding, culminating in widespread borrowing by state trust funds and the dire financial condition of the program, raises critical questions about the ability of the program to function as it has in the past.

To be sure, no one would argue that forward funding implies that a state should never have to borrow to pay benefits. Further, the program is designed to allow states significant latitude in deciding how much (and how) to tax their employers and how much to pay in benefits. Further, a lack of consistent standards for trust fund “adequacy” and the decentralization of UI policy make it understandable, and to some parties even desirable, that forward funding of trust funds varies across states and over time.

Nevertheless, Labor’s prognosis for the ability of borrowing states to repay their loans to avoid employer tax penalties is not optimistic. States are responding to low trust fund levels by raising tax rates on employers, which could undermine recovery. Meanwhile, any increased borrowing could change the nature of the program’s federal–state partnership, with the federal government taking on more chronic funding responsibility for paying benefits rather than providing, as originally envisioned, a backstop to states when they experience financial emergencies. Weakening forward funding could put pressure on states to reduce benefits, which might compromise the program’s goal of providing macroeconomic stability during recessions.

Now is the time, therefore, to consider changes to federal program policies that could better ensure the long-term financial structure of UI funds. The fact that states with an indexed taxable wage base have a better record for maintaining solvency and in some cases weathering high unemployment suggests one direction that federal policy makers might take to preserve the program without compromising state needs for flexibility.

Appendix 1: Major Characteristics of State UI Programs, as of March 2010

TABLE A-1
Major Characteristics of State UI Programs, as of March 2010

State	Weekly benefit formula	Min. weekly benefit	Max. weekly benefit	Number of benefit weeks	Min. payroll size for benefit eligibility	2010 taxable wage base (per worker (<i>italics</i> = indexed to wages))	2010 min. and max. employer tax rates (new employer rate)
AL	1/26 average of 2 highest quarters	\$45	\$265	15–26	20 weeks or \$1,500 in any quarter	\$8,000	0.44% 6.04% 2.70%
AK	0.9–4.4% of annual wages + \$24 per dependent up to \$72	\$56–128	\$370–442	16–26	Any size ^a	<i>\$34,100</i>	1.00% 5.40% 1.96%
AZ	1/25 high quarter wages	\$60	\$240	12–26	20 weeks or 1,500 in any quarter	\$7,000	0.02% 5.40% 2.00%
AR	1/26 high quarter wages	\$79	\$441	9–26	One employee for 10 or more days in a calendar year	\$12,000	0.90% 6.80% 3.70%
CA	1/23 to 1/26 high quarter wages	\$40	\$450	14–26	Over 100 in any quarter	\$7,000	1.50% 6.20% 3.40%

Table A-1 continues, next page

State	Weekly benefit formula	Min. weekly benefit	Max. weekly benefit	Number of benefit weeks	Min. payroll size for benefit eligibility	2010 taxable wage base (per worker base (per worker <i>italics</i> = indexed to wages))	2010 min. and max. employer tax rates (new employer rate)
IA	1/19 to 1/23 high quarter wages for claimants with dependents	\$56–67	\$374–459	9–26	20 weeks or 1,500 in any quarter	<i>\$24,500</i>	0 8.00% 1.00%
KS	4.25% high quarter wages	\$109	\$436	10–26	20 weeks or 1,500 in any quarter	\$8,000	0 7.40% 4.00%
KY	1.3078% base period wages	\$39	\$415	15–26	20 weeks or \$1,500 in any quarter	\$8,000	1.00% 10.00% 2.70%
LA	1/25 of the average of wages in 4 quarters of base period $\times 1.05 \times 1.15$	\$10	\$247	26	20 weeks or 1,500 in any quarter	\$7,700	0.10% 6.20% 2.89%
ME	1/22 average wages paid in 2 highest quarters of base period + \$10 per dependent up to 1/2 weekly benefit amount	\$62–93	\$356–534	22–26	20 weeks or 1,500 in any quarter	\$12,000	0.44% 5.40% 1.57%
MD	1/24 high quarter wages + \$8 per dependent up to 5 dependents	\$25–65	\$410	26	Any size	\$8,500	0.60% 9.00% 2.20%
MA	50% average weekly wage + \$25 per dependent up to 1/2 weekly benefit amount	\$33–49	\$629–943	10–30	13 weeks or 1,500 in any quarter	\$14,000	1.26% 12.27% 2.83%
MI	4.1% high quarter wages + \$6 for each dependent up to 5	\$117–147	\$362	14–26	20 weeks or 1,000 in calendar year	\$9,000	0.60% 10.30% 2.70%
MN	Higher of 50% of 1/13 high quarter wages up to 43% of state average weekly wages or 50% of 1/52 base period wages up to 66-2/3% of state average weekly wages	\$38	\$377–585	11–26	Any size	<i>\$27,000</i>	0.556% 10.70% 2.3116%
MS	1/26 high quarter wages	\$30	\$235	13–26	20 weeks or 1,500 in any quarter	\$7,000	0.70% 5.40% 2.70%
MO	4.00% of the average of the 2 high quarter wages	\$35	\$320	8–26	20 weeks or 1,500 in any quarter	\$13,000	0.00% 9.75% 3.51%

Table A-1 continues, next page

State	Weekly benefit formula	Min. weekly benefit	Max. weekly benefit	Number of benefit weeks	Min. payroll size for benefit eligibility	2010 taxable wage base (per worker base (per worker <i>italics</i> = indexed to wages))	2010 min. and max. employer tax rates (new employer rate)
MT	1% base period wages or 1.9% wages in 2 high quarters	\$125	\$422	8–28	\$1,000 in current or preceding year	<i>\$26,000</i>	0 6.12% 2.70%
NE	1/2 average weekly wages	\$30	\$318	1–26	20 weeks or 1,500 in any quarter	\$9,000	0 5.40% 1.29%
NV	1/25 high quarter wages	\$16	\$400	12–26	225 in any quarter	\$27,000	0.25% 5.40% 2.95%
NH	1–1.1% annual wages	\$32	\$427	26	20 weeks or 1,500 in any quarter	\$10,000	0.10% 6.50% 2.70%
NJ	60% of claimant's average weekly wage + dependents allowance	\$87–100	\$600	1–26	1,000 in any year	<i>\$29,700</i>	0.30% 5.40% 2.6825%
NM	60.0% of average weekly wage paid in base period quarter in which wages were highest	\$71–106.50	\$426–526	16–26	20 weeks or 450 in any quarter	<i>\$20,800</i>	0.03% 5.40% 2.00%
NY	1/26 high quarter wages unless high quarter wages ≤ \$3,575 then, 1/25 high quarter wages	\$64	\$405	26	300 in any quarter	\$8,500	0.70% 8.70% 4.10%
NC	1/26 high quarter wages	\$43	\$505	13–26	20 weeks or 1,500 in any quarter	\$19,700	0.00% 6.84% 1.20%
ND	1/65 of wages in 2 high quarters + 1/2 wages in 3rd high quarter	\$43	\$431	12–26	20 weeks or 1,500 in any quarter	<i>\$24,700</i>	0.20% 9.86% 1.60%
OH	1/2 claimant's average weekly wage + dependents allowance of \$1–133 based on claimant's average weekly wage and number of dependents	\$106	\$375–508	20–26	20 weeks or 1,500 in any quarter	\$9,000	0.30% 9.00% 2.70%
OK	1/23 high quarter wages	\$16	\$430	18–26	20 weeks or \$1,500 in any quarter	<i>\$14,900</i>	0.10% 5.50% 1.20%
OR	1.25% base period wages	\$115	\$493	3–26	18 weeks or 1,000 in any quarter	<i>\$32,100</i>	0.90% 5.40% 2.40%

Table A-1 continues, next page

State	Weekly benefit formula	Min. weekly benefit	Max. weekly benefit	Number of benefit weeks	Min. payroll size for benefit eligibility	2010 taxable wage base (per worker (italics = indexed to wages))	2010 min. and max. employer tax rates (new employer rate)
WI	4% high quarter wages up to maximum weekly benefit amount	\$54	\$363	14–26	20 weeks or 1,500 in any quarter	\$12,000	0 8.50% 3.25%
WY	4% high quarter wages	\$31	\$438	11–26	Any size	<i>22,800</i>	0.30% 9.10% 1.60%

Source: ETA, "Significant Provisions of State UI Laws," revised March 2010.

^aFor those states with "any size," all workers are covered regardless of payroll size or weeks worked. States may have different thresholds for agricultural, domestic, and non-profit employing units.

Appendix 2: Various UI Program Statistics

TABLE A-2
States with Loans from the Federal Unemployment
Account, as of December 21, 2010 (Dollars in Millions)

State	12/21/10 balance	State	12/21/10 balance
Alabama	\$283.0	Michigan	\$3,810.4
Arizona	\$225.0	Minnesota	\$503.9
Arkansas	\$330.9	Missouri	\$722.1
California	\$9,257.7	Nevada	\$607.0
Colorado	\$402.9	New Jersey	\$1,749.6
Connecticut	\$498.5	New York	\$3,176.9
Delaware	\$27.5	North Carolina	\$2,468.7
Florida	\$1,896.1	Ohio	\$2,314.2
Georgia	\$509.0	Pennsylvania	\$3,008.6
Hawaii	\$8.1	Rhode Island	\$225.5
Idaho	\$202.4	South Carolina	\$886.7
Illinois	\$2,287.6	Vermont	\$33.6
Indiana	\$1,935.0	Virgin Islands	\$17.4
Kansas	\$88.2	Virginia	\$346.9
Kentucky	\$796.2	Wisconsin	\$1,424.8
Massachusetts	\$387.3	United States	\$40,431.4

Source: Employment and Training Administration, Department of Labor.

TABLE A-3
 UI Contributions, Benefits, and Reserves as a
 Percentage of Total UI-Eligible Wages, 1979–2008

Year	Contributions	Benefits	Net reserves
1979	1.28	0.91	0.91
1980	1.11	1.34	0.64
1981	1.03	1.17	0.51
1982	1.04	1.76	-0.23
1983	1.18	1.44	-0.47
1984	1.37	0.92	0.16
1985	1.31	0.96	0.68
1986	1.16	0.99	0.99
1987	1.05	0.81	1.38
1988	0.97	0.69	1.71
1989	0.86	0.71	1.92
1990	0.75	0.86	1.88
1991	0.71	1.20	1.49
1992	0.78	1.10	1.19
1993	0.88	0.92	1.25
1994	0.92	0.86	1.32
1995	0.87	0.80	1.40
1996	0.80	0.76	1.43
1997	0.73	0.64	1.50
1998	0.62	0.58	1.51
1999	0.56	0.56	1.47
2000	0.54	0.52	1.46
2001	0.52	0.81	1.24
2002	0.53	1.08	0.96
2003	0.67	1.03	0.64
2004	0.78	0.81	0.59
2005	0.82	0.69	0.67
2006	0.76	0.62	0.78
2007	0.67	0.64	0.80
2008	0.62	0.85	0.60
Annual average, 1979–2008	0.86	0.90	1.04

Source: *Unemployment Insurance Financial Data Handbook*, Employment and Training Administration, Department of Labor.

TABLE A-4
 UI-Taxable Wages as a Percentage of Total UI-Eligible
 Wages, States with Indexed Taxable Wage Bases
 vs. Other States, 1979–2008

Year	U.S. overall	States with indexed base	Non-indexing states
1979	0.47	0.59	0.50
1980	0.45	0.57	0.47
1981	0.42	0.57	0.44
1982	0.41	0.57	0.43
1983	0.43	0.58	0.46
1984	0.43	0.58	0.45
1985	0.42	0.58	0.44
1986	0.41	0.57	0.43
1987	0.40	0.57	0.41
1988	0.39	0.55	0.40
1989	0.39	0.56	0.40
1990	0.38	0.56	0.38
1991	0.37	0.54	0.37
1992	0.36	0.56	0.36
1993	0.36	0.56	0.36
1994	0.36	0.57	0.36
1995	0.35	0.57	0.35
1996	0.34	0.56	0.34
1997	0.33	0.56	0.33
1998	0.32	0.55	0.32
1999	0.32	0.55	0.31
2000	0.31	0.55	0.31
2001	0.30	0.55	0.30
2002	0.30	0.56	0.29
2003	0.29	0.56	0.29
2004	0.29	0.55	0.27
2005	0.29	0.55	0.27
2006	0.28	0.55	0.26
2007	0.27	0.54	0.25
2008	0.27	0.53	0.25
Change, 1979–2008	–0.20	–0.06	–0.25

Source: Author calculations based on data from *Unemployment Insurance Financial Data Handbook*, Employment and Training Administration, Department of Labor.

TABLE A-5
States with UI Solvency or Social Cost Taxes as of 2010

State	Purpose of tax	State	Purpose of tax
AL	Social cost	NY	Solvency
AK	Solvency	OH	Social cost
AR	Solvency	OK	Solvency
CO	Solvency and social cost	PA	Solvency and social cost
DE	Solvency	RI	Solvency
IL	Solvency	TX	Solvency and social cost
LA	Solvency and social cost	UT	Social cost
MA	Solvency	VA	Solvency and social cost
MN	Solvency	WA	Solvency and social cost
NH	Solvency	WI	Solvency
NJ	Solvency	WY	Social Cost

Source: ETA, Comparison of State Unemployment Insurance Laws, January 1, 2010.

Endnotes

¹ In this report we use “forward funding” to refer to the practice of states accumulating reserves in unemployment insurance trust funds in anticipation of increased outlays in the future.

² Some states allow for some workers who quit for certain work-related or personal reasons to be eligible for UI benefits. The American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, Div. B, §2003, authorized the Secretary of Labor to make unemployment compensation modernization incentive payments to states that amend their laws to allow UI payments to individuals who quit employment for certain compelling family reasons such as following a spouse to a new job.

³ Alaska, New Jersey, and Pennsylvania also withhold UI taxes from employee wages.

⁴ 26 U.S.C. §3301.

⁵ 26 U.S.C. §3302.

⁶ GAO has conducted past reports on UI administrative funding and problems states have had with funding technologies to improve the efficiency and integrity in administering the program. See GAO, Human Service Programs: Demonstration Projects Could Identify Ways to Simplify Policies and Facilitate Technology Enhancements to Reduce Administrative Costs, GAO-06-942 (Washington, D.C.: Sept. 19, 2006); and Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments, GAO-02-697 (Washington, D.C.: July 12, 2002).

⁷ Title XII of the Social Security Act, 42 U.S.C. §§1321–1324.

⁸ Labor exchange services include job search assistance, job referral, placement assistance for job seekers, re-employment services to UI claimants, and recruitment services to employers with job openings.

⁹ See GAO, Unemployment Insurance: States’ Tax Financing Systems Allow Costs to Be Shared Among Industries, GAO-06-769 (Washington, D.C.: July 2006), for a more detailed discussion of experience rating. Some states levy social cost taxes to recover uncollected benefit costs, such as those paid to

unemployed individuals but not charged to the firms for whom the employers had worked. See Table 4 in appendix IV for more details.

¹⁰ The term “Reed Act” refers to a part of the Employment Security Financing Act of 1954, Pub. L. No. 83-567. The provisions referred to are found in Title IX of the Social Security Act, 42 U.S.C. §§1101–1110.

¹¹ 42 U.S.C. §1103(c)(2).

¹² For more information on congressional changes to the Reed Act’s statutory ceilings, see Congressional Research Service, *The Unemployment Fund and Reed Act Distributions*, RS22006 (Washington, D.C.: Feb. 17, 2009).

¹³ New Hampshire allows for quarterly adjustments to tax rates based on quarterly measurements of the trust fund, and Tennessee can activate six-month tax schedules.

¹⁴ 42 U.S.C. §1322(b)(2). In addition to repaying a loan by September 30, the state may not have another advance during the calendar year and must meet funding goals established under regulations issued by the Secretary of Labor. The requirement that Labor establish funding goals was added by the Balanced Budget Act of 1997 (Pub. L. No. 105-33, §5404). Labor has published proposed rules on funding goals that have yet to be finalized. See 74 Fed. Reg. 30,402 (June 25, 2009). ARRA provided that all loans from the federal government are interest free until December 31, 2010, 42 U.S.C. §1322(b)(10) (as added by Pub. L. No. 111-5, Div. B, §2004).

¹⁵ See 26 U.S.C. §3302(f).

¹⁶ This rate of 13.5% or greater is for the most recent 12-month period for which data are available.

¹⁷ 42 U.S.C. §1322(b)(9).

¹⁸ Unless stated otherwise, in this report “total wages” are total wages in UI-covered employment.

¹⁹ The IUR is the average weekly number of insured workers divided by the sum of average monthly UI-covered employment and average monthly “reimbursable” employment, which includes the UI-covered public and non-profit sectors. A state’s IUR is typically much lower than its total unemployment rate because many unemployed workers do not qualify for benefits, typically because of low applications, eligibility denials, or benefit exhaustion.

²⁰ Duration figures reported by ETA equal the number of weeks compensated during the year divided by the number of first payments. The figures may include more than one period of continuous unemployment. It excludes all unemployment for which no benefits were paid, such as waiting periods, disqualifications, and any time after exhaustion of benefits.

²¹ National Commission on Unemployment Compensation, *Unemployment Compensation: Final Report* (July 1980).

²² GAO, *Unemployment Insurance: Trust Fund Reserves Inadequate*, GAO/HRD-88-55 (Washington, D.C.: Sept. 26, 1988).

²³ Federal State Unemployment Compensation System: A Study Prepared by the Congressional Research Service of the Library of Congress (Washington, D.C.: Sept. 8, 1988).

²⁴ GAO, *Unemployment Insurance: Program’s Ability to Meet Objectives Jeopardized*, GAO/HRD-93-107 (Washington, D.C.: Sept. 28, 1993).

²⁵ Advisory Council on Unemployment Compensation, *Defining Federal and State Roles in Unemployment Insurance* (Washington, D.C.:1996).

²⁶ Although the government does not officially set dates for the start and end of recessions, business cycle dates announced by the National Bureau of Economic Research (NBER) Business Cycle Dating Committee are widely accepted. While the committee does not set hard criteria for defining recession, most of the periods defined this way consist of two or more quarters of declining gross domestic product. For more on NBER’s process for determining business cycle dates, see http://www.nber.org/cycles/recessions_faq.html. According to NBER, the recessions began in 1980 Q1, 1981 Q3, 1990 Q3, 2001 Q1, and 2007 Q4. While NBER officially dates separate recessions beginning in 1980 and 1981, we consider them as one economic event given the short period of recovery between them. Because of data constraints, we use end-of-year HCM and IUR data for the 1980 and 1990 recessions, and quarterly data for the 2001 and 2007 recessions. We categorized a state as a “borrowing” state if it had an unpaid end-of-year loan balance to the federal government during the business cycle starting with each recession. Additional states that we do not

categorize as a borrower may have received cash flow loans that they repaid during the same calendar year as long as they had a zero loan balance at the end of the year.

²⁷ Some states have indexed their taxable wage base for only certain years from 1979 to 2010; others have raised and lowered their bases, without indexing. We categorize states as indexing their wage base if the base in a particular year exceeded the FUTA tax base and is adjusted based on changes in average wages in the state.

²⁸ In 1982, Pub. L. No. 97-248 §271(c) amended 26 U.S.C. §3302(b), increasing the state maximum rate to 5.4% effective in 1985.

²⁹ To ensure that all employers receive the maximum credit of 5.4% against the federal payroll tax, all state laws provide for assignment of a contribution rate of 5.4% or higher. Present federal law permits reduced rates for newly subject employers or employers with at least one year of experience with unemployment or other factors bearing a direct relation to unemployment risk. As noted in our 2006 report, the actual maximum tax rate in a state can change from one year to the next because of the use of different schedules or changes in factors used to calculate a tax rate by formula. For example, Massachusetts state law caps its maximum tax rate at 15.4%, but as of July 2009 the state had set the maximum rate at 12.27%.

³⁰ DOL calculates a state's adequate financing rate by estimating the tax rate that would be charged to all employers if there were no experience rating. They assume the rate is equal to the amount needed to cover benefit payments plus a solvency amount (based on what a state would need to have in its trust fund to achieve an average high-cost multiple of 1).

³¹ See U.S. Department of Labor, Office of Workforce Security, Division of Fiscal and Actuarial Services, 2009: Significant Measures of State UI Tax Systems (Dec. 2009).

³² The states who met or exceeded their adequate financing rates from 2006–2009 were Maine, Mississippi, Montana, and New Mexico.

³³ The insured unemployment rate is calculated in terms of UI-covered employment, while the total unemployment rate is calculated as a percentage of the labor force.

³⁴ According to a 2007 GAO report, there is some evidence that the general decline in UI since the 1950s is partly explained by the reduction in union employment—making workers less aware of benefits—and the migration of manufacturing from high-benefit states to low-benefit states—making applying for benefits less remunerative. For more information, see GAO Unemployment Insurance: Low-Wage and Part-Time Workers Continue to Experience Low Rates of Receipt, GAO-07-1147 (Washington, D.C.: Sept. 7, 2007).

³⁵ States administer UI re-employment services to help claimants obtain employment before exhausting UI benefits. These services can impact UI trust fund levels by reducing the number of weeks claimants receive benefits. See GAO Unemployment Insurance: More Guidance and Evaluation of Worker-Profiling Initiative Could Help Improve State Efforts, GAO-07-680 (Washington, D.C.: June 2007); Unemployment Insurance: Enhancing Program Performance by Focusing on Improper Payments and Reemployment Services, GAO-06-696T (Washington, D.C.: May 4, 2006); Unemployment Insurance: Factors Associated with Benefit Receipt and Linkages with Reemployment Services for Claimants, GAO-06-484T (Washington, D.C.: Mar. 15, 2006); and Unemployment Insurance: Better Data Needed to Assess Reemployment Services to Claimants, GAO-05-413 (Washington, D.C.: June 2005).

³⁶ See GAO/HRD-88-55 and Unemployment Insurance: Program's Ability to Meet Objectives Jeopardized, GAO/HRD-93-107 (Washington, D.C.: Sept. 28, 1993).

³⁷ For comparison, the taxable wage base for contributions to Social Security, which is indexed to average wages, rose from \$35,700 per worker per year in 1983 to \$102,000 in 2008, an increase of 186%.

³⁸ This calculation does not correct for any changes in the wage distribution since 1983 that might affect the relationship between the taxable wage base and total UI revenue collected each year.

³⁹ For more on experience rating and the impact on UI tax rates, see GAO, Unemployment Insurance: States' Tax Financing Systems Allow Costs to Be Shared among Industries, GAO-06-769 (Washington, D.C.: July 2006)

⁴⁰ These efforts might include challenging laid-off employees' eligibility to receive benefits, trying to get a new experience rating by changing the identity of the company (perhaps through a sham sale or new name), or declaring that a firm's employees are independent contractors and therefore outside the UI system.

See GAO, Unemployment Insurance: Survey of State Administrators and Contacts with Companies Promoting Tax Avoidance Practices, GAO-03-819T (Washington D.C.: June 19, 2003) for more on this issue.

⁴¹ 42 U.S.C. §1322(b)(2)(C). In the preamble to its proposed regulations, the Department of Labor described three approaches it considered involving both solvency and tax effort criteria that states would have to meet in order to qualify for interest-free “cash flow” advances. In one approach, a state would need to maintain an AHCM of 1.0 in at least one of the five years prior to obtaining a loan and, for each year between the last year in which the solvency goal was met and the year of the potential loan, need to collect unemployment taxes (measured as a percentage of total wages) of at least 80% of the prior year’s rate; and the tax rate would have to be at least as high as 75% of the percentage of benefits paid out. A second approach would set only the solvency requirement, not the tax effort condition, and a third approach would define the solvency standard as a reserve ratio of 1.7% instead of an AHCM of 1.0. After reviewing all three approaches, DOL selected the first one to include in its proposed rule. See Employment and Training Administration, 20 CFR Part 606, “Federal–State Unemployment Compensation (UC) Program; Funding Goals for Interest-Free Advances; Proposed Rule,” 74 Fed. Reg. 30,402 (June 25, 2009). DOL officials told us that they planned to issue a final rule in June 2010 but may not implement the rule for a few years.