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ALL FOR NAUGHT?

Today's harmful policies are setting up the Unemployment Insurance System to repeat past mistakes, fail to stabilize the economy

BY ALEXANDRA FORTER SIROTA, DIRECTOR

This week, North Carolina government officials announced that the state will pay off the unemployment insurance (UI) debt it owed the federal government. Likely to follow within the year will be state tax cuts for employers even while the harsh benefit cuts for jobless workers remain in place and leave the state's UI system far weaker than it will need to be in the next recession.

The UI system exists to help jobless workers who become unemployed through no fault of their own. In so doing, the system protects our state's economy from freefall during recessions. To truly build a solvent and effective unemployment insurance system after the Great Recession, North Carolina must learn from past mistakes and ensure employers make adequate contributions during the recovery so that the system can provide temporary but adequate support to jobless workers in a downturn.

In the 2013 legislative session, lawmakers enacted various changes to the state's unemployment insurance system — most significantly, they reduced the amount of money recipients receive and the number of weeks they receive it, while also restricting eligibility. While jobless workers today have less help and support despite having lost their jobs through no fault of their own, policymakers made virtually no change in the amount state employers paid into the program through taxes. Long term, such a strategy will fail to create an Unemployment Insurance Trust Fund that is a healthy and viable way of supporting the economy during a downturn, and in the short term it means that most of the burden for debt repayment has been pushed onto jobless workers.

The result is that state financing of unemployment insurance is unlikely to put in enough funds in good times to protect the state during a downturn. As a result, the system would not be able to function in a downturn without either borrowing, further cutting payments to jobless workers or raising taxes on employers.

An important, quick and partial solution would be to set the funding level that triggers tax cuts for employers at a more appropriate level. This would allow the trust fund to reach a balance sufficient to cover the wages of jobless workers before employers can contribute less to the solvency of the system.

Cutting taxes before the balance is high enough, as would currently be the case, sets North Carolina up to repeat past problems. If employer taxes are automatically reduced before the state's UI Trust Fund is healthy, this would make this week's apparent milestone meaningless. It is therefore critical that policymakers establish triggers for tax cuts that are realistic so the program can protect the economy from freefall in a downturn.

Ensuring jobless workers benefits is difficult without building reserves today

Cuts to unemployment benefits in North Carolina have made it harder for jobless families to make ends meet and get back on their feet in an economy that is still providing too few jobs to go around. Far from helping the state's economy, the cuts have left thousands of North Carolinians with less money to spend on food, clothing and other necessities, which also harms local businesses.¹ The failure to establish a solvent trust fund in past good times was the justification for these recent cuts to benefits. And yet, these cuts are ultimately compromising the effectiveness of the unemployment insurance system.

Reductions to the maximum benefit amount, changes to the benefit formula calculation, reductions to the number of weeks available, and various restrictions on eligibility and requirements related to taking poverty level wage jobs have pushed North Carolina's system to the bottom of the national rankings. North Carolina's average weekly benefit amount of \$228 in 2014 put the state at 47th in the country.²

The way in which benefit payments are calculated in the state are unlike the formula in any other state in the country because it takes into account just the last two quarters of earnings not an average or high point in ones prior earning history. It is likely this change to the formula that is making the greatest contribution towards reducing the support to jobless workers. States with lower average weekly benefit amounts (AZ, AL, MS, LA, TN) actually have lower maximum benefit amounts than NC, suggesting that it is not the maximum benefit level that is reducing the average but the experience of many workers under the new formula.

North Carolina's jobless workers are disadvantaged relative to their peers in other states because the unemployment insurance system fails to reflect best practices for supporting workers as they seek their next job. Most critically, the system's support to the economy is compromised as unemployment insurance payments to workers no longer reflect earnings in the labor market. When workers are not able to meet their most basic needs during the time when that is important to stabilizing families and the economy, there are greater costs in other public systems and broader economic impacts like increased foreclosures and jobless workers leaving the labor force entirely.

New research from the Economic Policy Institute finds that North Carolina has seen the steepest decline in the number of short-term jobless workers (those out of work for 26 weeks or less) who receive unemployment insurance.³ Nationally, state unemployment insurance reached a historic low in the pre-Great Recession period with just 23 percent of jobless workers receiving state unemployment insurance. This decline means the program has drastically reduced support for workers who have lost their job and are looking for a new one.

The analysis takes into account just those jobless workers who are receiving the traditional 26 weeks of assistance offered by states. North Carolina ranks 43rd in the country for the percentage of short-term unemployed workers (those who have been out of work for 26 weeks or less) who received unemployment insurance in 2014. Just 20 percent of North Carolinians who are out of work receive unemployment insurance compared to 35 percent of jobless workers nationally. This is down 36.8 percent of short-term unemployed workers receiving benefits when the state ranked 24th among states for its reach those out of work.

Moreover, North Carolina has had the steepest decline in the percentage of unemployed receiving benefits since cuts went into effect. Prior to the cuts, North Carolina was just 1.3 percentage points below all other states that did not cut maximum durations. Now, North Carolina's rate sits 17.1 percentage points below these states.

Of course, reciprocity of unemployment insurance should decline in a recovery. As jobs return and workers move into employment, fewer people will receive unemployment insurance. That said, improving economic conditions do not fully explain the drop off in unemployment reciprocity in North Carolina over the last few years. The recovery has not completely erased the challenges to finding employment in North Carolina. The national analysis by the Economic Policy Institute shows that states reducing available weeks have seen far steeper declines in reciprocity than states that did not.⁴ Policy choices are partly driving the historic decline in unemployment insurance's reach.

Fewer jobless workers accessing unemployment insurance and fewer dollars paid compromises the system

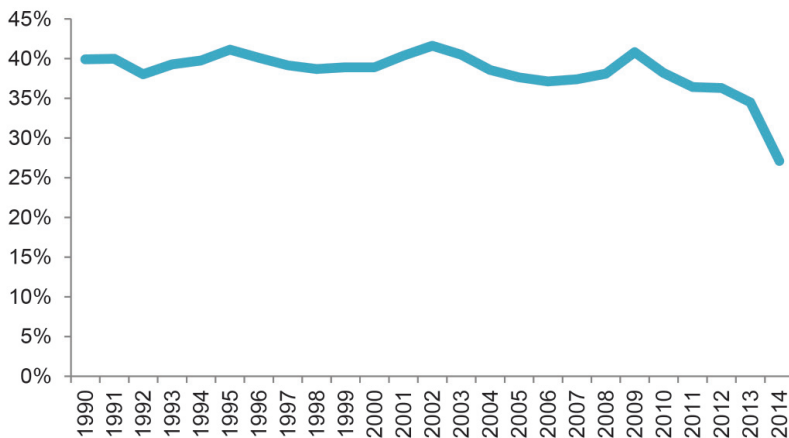
With fewer people receiving unemployment insurance and cuts to the level of unemployment insurance paid, the ability of the unemployment insurance system to support the economy in a downturn is undermined. Jobless workers need partial wage replacement so that they can continue to meet their basic needs and spend in local economies. If the wage replacement rate of unemployment insurance is insufficient, jobless workers will have to stop spending or turn to other public benefits to make sure they can put food on the table or provide shelter for their families.

The average weekly benefit amount as a share of the average weekly wage in employment that is covered by the unemployment insurance has fallen since the 2013 changes. The replacement rate of wages through unemployment insurance averaged 39 percent from 2012 to 1990. As of 2014, the average weekly benefit amount was 27 percent of the average weekly wage in covered employment.⁵ Another measure of the replacement rate of unemployment insurance that takes into

account jobless workers' actual weekly wages shows a steep drop off as well. From 2013 to 2014, this measure of the replacement of wages fell in North Carolina by 13 percentage points. For the nation as a whole, it fell by just one percentage point.⁶

Economists generally agree that an ideal replacement rate for wages of jobless workers is 50 percent. While historically that ideal threshold has almost never been met, the replacement rate nationally and in North Carolina has been relatively stable at around 35 percent. The decline in unemployment insurance payments' coverage of wages for the average worker is likely driven by the arbitrary maximum threshold and the change to the way that benefits are calculated. These measures fail to take into account the longer trend in worker's earnings.

FIGURE 1: Average unemployment insurance payments no longer replace wages at the same rate, undermine the power of the system to support the economy



SOURCE: US DOL, UI Data Summary

The road to solvency starts with establishing effective targets to reach before employers receive a tax cut

To ensure that unemployment insurance can support the state's economy from further decline in a downturn, it is critical to address both the level of receipt of unemployment insurance and the rate at which wages are replaced. That, in turn, requires an adequate financing system is in place, one that recognizes the efficient and effective operating level of the program.

Unfortunately, under current law, employers could begin receiving tax cuts before the unemployment insurance trust fund balance achieves a healthy level to sustain the system in the next downturn. The minimum safe level tax, set at 20 percent of employer contributions, is set to trigger off once the balance in the Trust Fund reaches the flat amount of \$1 billion. The formula dictating employer contribution rates will be reduced, delivering an effective tax cut to employers, once the Trust Fund reaches a reserve ratio of 1.0. This means that the Trust Fund would have just \$1 for every \$1 in insured wages in the economy. Both of these thresholds are set too low to allow the Trust Fund balance to reach adequate levels to support the economy.

If revenue remains relatively stable to the prior 12 month experience and benefits paid out follows the 2014 annual rate of payment, North Carolina will reach the \$1 billion threshold in the Trust Fund by

SOLVENCY MEASURES BASED ON HISTORIC EXPERIENCE

A common way to measure the solvency of an unemployment insurance system is to take into account historic experience in paying out benefits so that the system can cover workers during periods of high job loss. This measure, called the Average High Cost Multiple (AHCM), is the average of the three most recent high cost calendar years that include either 3 recessions or at least 20 years' history.

The Advisory Council on Unemployment Compensation, a federal advisory panel, recommended in 1995 that states maintain a pre-recession AHCM of 1.0. To reach that threshold in North Carolina, the Trust Fund would need to have a balance of \$2.1 billion.

While proponents of the drastic reductions in unemployment insurance benefits would argue that this measure is meaningless under the new normal, it is important to note that the system prior to the 2013 cuts represented the middle of the road relative to other states. Therefore the use of this solvency measure is relevant to determining the balance needed in the Trust Fund to effectively meet the mandate of the unemployment insurance to stabilize the economy.

mid-2016. At that time, employers will see the surtax trigger off. Again, this figure is far below what is needed to ensure a healthy system.⁷ A flat dollar amount rather than the use of a formula based on how benefits should replace wages underestimates the reserves that will be needed to contend with future downturns. As the unemployment rate goes up, an increase in the maximum weeks to 20 will occur, driving the need for the system to pay out higher benefit payments. It is also likely that more jobless workers will exhaust benefits thereby remaining in receipt of unemployment insurance for the full period available.

The reserve ratio of funds as a share of total covered wages, which is set at 1.0 in current law, is problematic. This would trigger automatic reductions in employer contributions once the Trust Fund balance reaches approximately \$1.3 billion. While no formal guidance has been issued, economists have generally accepted reserve ratios of 2.0 – twice North Carolina's current ratio in statute-- as a sign of a healthy Trust Fund.

Policymakers should establish thresholds that reflect a more fiscally conservative approach. Such an approach would maximize the chances that North Carolina could avoid future borrowing, additional benefit cuts for workers or tax increases on employers. This would mean:

1. **Adopting a realistic surtax threshold. The threshold that causes the surtax to turn on and off should be based on a formula that reflects the replacement rate desired and current wage conditions; and**
2. **Establishing that the reserve ratio must meet 2.0 before employers can expect a reduction in their tax responsibility.**

The strength of the unemployment insurance system in delivering on its goals is achieved only through funding it in a fiscally responsible way. The first step on that road is setting appropriate thresholds for tax changes. Only by doing so can we ensure that the system can support jobless workers as they seek new employment opportunities, spend to meet basic needs and support local businesses.

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