

Unemployment Insurance: Problems and Prospects

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Summary

In 2011, three years after the Great Recession began, state unemployment insurance (UI) programs are in their worst financial position since they were established by the Social Security Act of 1935. While benefit outlays from the UI program have helped stabilize incomes for millions of families and provided a boost to the economy's aggregate demand, net UI trust fund reserves have declined sharply. The current financing problems occur because reserves were low before the Great Recession; deep and prolonged unemployment further reduced revenues and increased outgo. In the 16 states that index their taxable wage base to keep pace with average wage growth, UI reserves are more adequate and most such states have avoided the need to borrow from the federal government. The federal taxable wage base used to collect federal UI taxes has remained at \$7,000 since 1983. (In contrast, the Social Security OASDI tax base is \$106,800 and is indexed to grow with average wages.) This brief discusses causes of the unprecedented prevalence and scale of borrowing by state UI programs during and after the Great Recession and considers current legislative proposals to improve solvency of these UI programs.

Introduction

In mid-2011 state unemployment insurance (UI) programs are in their worst financial situation since the programs were established by the Social Security Act of 1935. Of the 53 programs (the 50 states, plus the District of Columbia, Puerto Rico, and the Virgin Islands), 36 have secured loans from the U.S. Treasury since 2007. At the end of August, 28 had outstanding Treasury loans that totaled \$37 billion. Since the end of 2007 net trust fund reserves (gross reserves less loans) had declined by \$62 billion. The states now face the prospect of raising employer payroll taxes to rebuild trust fund balances while the economy grows only moderately and the unemployment rate remains close to 9.0 percent of the labor force.

The UI program is designed to act as an automatic stabilizer of macroeconomic activity. The recent trust fund drawdowns mean that UI benefit payments have far exceeded the employer UI payroll taxes that provide program revenue. Benefit outlays have helped stabilize incomes for millions of families as well as providing a boost to aggregate demand. Because state UI indebtedness has now been present for more than two years, the states are facing difficult decisions in setting UI tax rates for employers and finding sources to pay for interest charges on loans from the Treasury that have been accruing since January of this year.

This brief examines the issues in UI financing and discusses ways to improve the long run solvency of this important social insurance program. The primary focus is the so called regular UI program which pays up to 26 weeks of benefits in most states and is financed by employer payroll taxes. There are five sections. The first two identify the causes of the financing problem, focusing respectively on the long-run and short-run. Section three discusses issues in benefit payments while section four examines program revenue. Finally, section five proposes changes to improve the future balance between program outlays and revenues including federal legislative proposals of 2011.

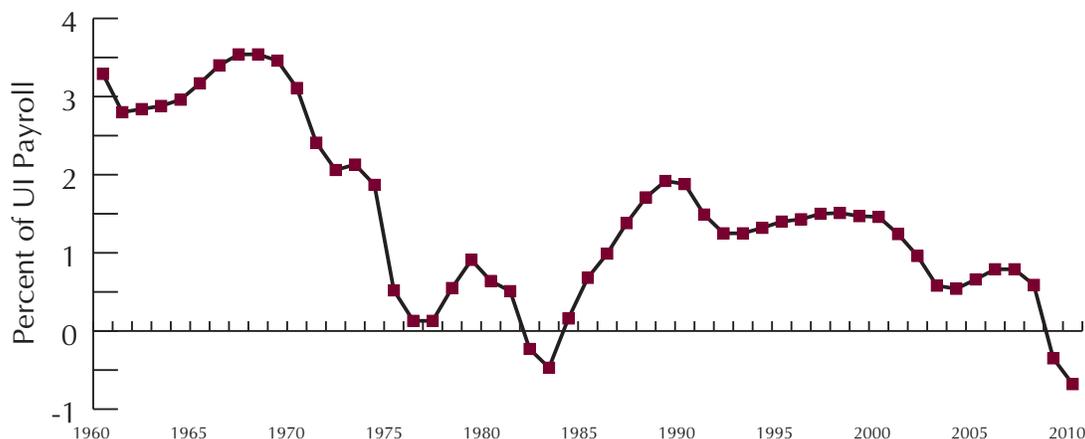
The Long-Run Funding Imbalance

Because UI trust funds grew substantially during World War II, the initial recessions of the post-war economy caused little concern about fund adequacy. Funding problems were experienced by a few states such as Alaska, Michigan and Pennsylvania during the 1950s and 1960s, but nearly all states had reserves sufficient to make recession-related benefit payments. An important change occurred during the 1970s when net reserves declined during the recession of 1970 and especially during 1974-1975 (note Figure 1). The recession of the mid-1970s was the first when substantial numbers of state UI programs borrowed from the Treasury to finance part of benefit payments. A total of 25 state UI programs plus Puerto Rico borrowed more than \$5 billion, and several states were slow to repay their loans.

Figure 1 summarizes the aggregate trust fund situation from 1960 to 2010. It displays the annual end-of-year reserve ratio (net trust fund reserves as a percent of covered payroll) for all UI programs combined. Note how the reserve ratio decreased from 3.3 percent in 1960 to just 0.1 percent in 1975. For all subsequent years this ratio never again reached 2.0 percent of payroll. Since annual benefit payouts can be as high as 1.5-2.0 percent of payroll during a recession, the reserve cushion depicted in Figure 1 has been quite modest for more than three decades.

Figure 1 identifies just one period since 1980 when UI programs engaged in substantial trust fund building. The reserve ratio increased from -0.47 percent in 1983 to 1.92 percent in 1989. In contrast, the recoveries of 1993-1999 and 2003-2007 were accompanied by only modest growth

**Figure 1. Unemployment Insurance Reserve Ratio, 1960-2010
Net Trust Fund Reserves as Percent of Covered Payroll, Dec. 31**

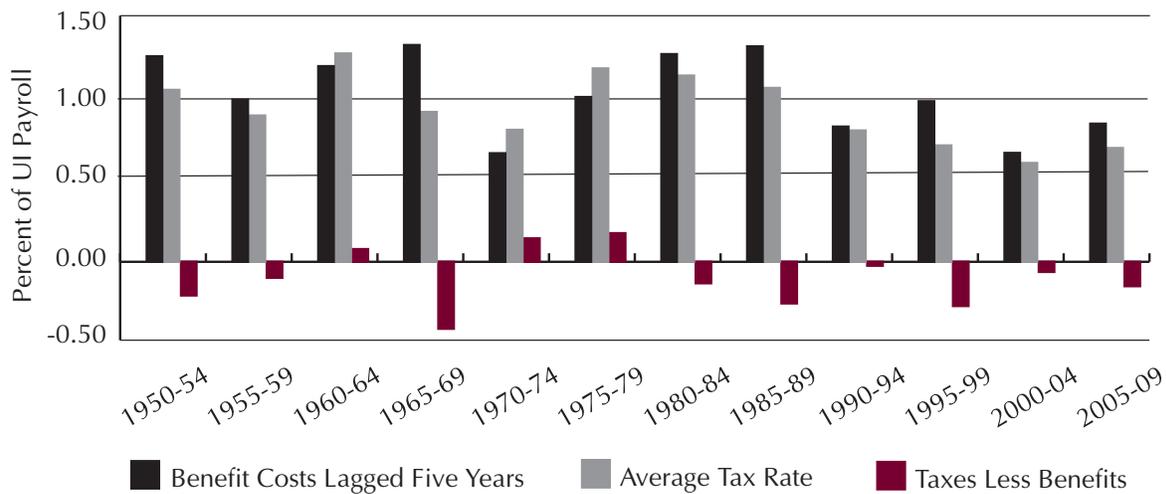


Source: *Unemployment Insurance Financial Data Handbook*, Office of Workforce Security, USDOL-ETA.

in the reserve ratio. During these two recoveries, states enacted several tax cuts that limited the increase in tax revenues and retarded the restoration of trust fund balances to former levels.

Textbook descriptions of the UI program emphasize the role of experience rating in determining tax rates for individual employers and aggregate tax revenues over the business cycle. The post-recession response of taxes restores trust fund balances so that UI is able to perform its stabilizing role during the next recession. Experience rating operates with a lag. Figure 2 gives a visual representation of the lagged tax response. Annual taxes and benefits are measured as a percent of payroll and averaged for five-year periods. The 12 entries extend from 1950-1954 to 2005-2009. In each period taxes are measured for the current five years, but benefits have been lagged five years. Figure 2 also shows the net difference between taxes and benefit payments. Negative entries identify periods when benefits exceeded taxes, e.g., 1950-1954.

**Figure 2. UI Benefit Costs and Average Tax Rates
1950-54 to 2005-09**



Source: *Unemployment Insurance Financial Data Handbook*, Office of Workforce Security, USDOL-ETA.

Figure 2 helps to make three important points. First, taxes and benefits were more nearly balanced during 1950-1979 than during 1980-2009. Three of the first six five-year periods had average taxes that exceeded average benefits while not a single five-year period between 1980 and 2009 had an excess of taxes over benefits. Second, benefit payments before 1980 were generally higher than after 1980. The benefit percentages were 1.00 percent or higher in five of the first six five-year periods but in just three of the six periods after 1980. During the earlier 30 years, benefits averaged 1.08 percent of payroll while they averaged 0.99 percent during 1980-2009. Third, employer taxes have been noticeably lower during recent years. The two 30-year averages were respectively 1.03 percent and 0.84 percent. Despite somewhat lower benefit costs in the recent 30-year period, UI programs lost reserves because the reduction in taxes was twice the size of the decline in benefit costs, i.e., from 1.08 to 0.99 percent for benefits compared to 1.03 to 0.84 percent for taxes. The long run loss of UI reserves presents no mystery. Employer UI taxes have decreased too much to adequately finance the regular state UI benefit payments.

Proximate Causes for the Current Funding Crisis

The current financing crisis in state UI programs can be described as a perfect storm resulting from the constellation of four identifiable factors: 1) a deep and prolonged recession, 2) low reserves prior to the recession, 3) the timing of the downturn in 2008 and 4) continued low levels of employment through 2011.

First, the recession that started in December 2007 was the deepest of the entire post-World War II period. Between 2007 and 2009 the average unemployment rate doubled, increasing from 4.6 percent to 9.3 percent and then to 9.6 percent in 2010. Unemployment reached 14.8 million in 2010 and has remained above 13.5 million throughout 2011. Associated with increased unemployment has been an increase in average unemployment duration which reached the unprecedented levels of 24.4 and 33.0 weeks in 2009 and 2010. The severity of the downturn has led many to describe it as the Great Recession.

Table 1 summarizes developments in unemployment and UI benefits between 2007 and 2010. It depicts aggregate unemployment in column (1) and then UI first payments, weeks compensated and benefit payments from the regular UI program that pays up to 26 weeks of benefits. The table does not include long-term benefits financed by the federal government.

**Table 1. Unemployment and UI Benefits, 2007 to 2010:
State-Financed UI Programs**

| | Unemployed Persons (millions) (1) | UI First Payments (millions) (2) | UI Weeks Compensated (millions) (3) | UI Benefit Payments (billions) (4) |
|------|--|---|--|---|
| 2007 | 7.1 | 7.6 | 116.3 | \$30.5 |
| 2008 | 8.9 | 10.1 | 149.5 | \$40.7 |
| 2009 | 14.3 | 14.2 | 266.0 | \$75.9 |
| 2010 | 14.8 | 10.7 | 203.4 | \$54.5 |

Source: Annual data from the U.S. Department of Labor. Column (1) from the Bureau of Labor Statistics. Columns (2)-(4) from the Office of Unemployment Insurance.

The entries in columns (2)-(4) show a large response of the regular UI program to the Great Recession. Between 2007 and 2009 first payments of new UI claims roughly doubled while weeks compensated and total benefit payments increased by 129 and 149 percent respectively. The payments shown in column (4) are the responsibility of the state UI trust funds.

Second, the trust funds prior to the Great Recession were low relative to the scale of the economy. Recall from Figure 1 that the reserve ratio in December 2007 was 0.80 percent of covered payroll, a historic pre-recession low. According to a common actuarial measure termed the reserve ratio multiple,¹ aggregate pre-recession reserves represented only about four months of benefit

1 The reserve ratio multiple, also termed the high cost multiple, is the ratio of two ratios. The numerator ratio is the reserve ratio, reserves as a percent of covered payroll as depicted in Figure 1. The denominator is the highest previous annual payout rate, measured as a percent of payroll for the high cost 12 month period. A multiple of 1.0 is suggested as necessary for fund adequacy. This means that the trust fund balance should represent at least 12 months of benefits at the highest-ever payout rate.

payouts when payouts occur at the highest previous payout rate. The recommended standard is for 12 months of benefits. Low reserves coupled with a very serious recession caused states to need large scale loans in early 2009 and borrowing continued into 2010 and early 2011.

The third and fourth factors (the timing of the downturn and continuing low employment) have both affected UI tax revenue. While each is of lesser importance than the severity of the recession and low pre-recession trust fund balances, both have had measurable effects.

Most states set UI taxes for the upcoming calendar year based on trust fund reserves as of June 30th. Usually net reserves on June 30th are similar to reserves at the end of the year, but not in 2008. Because UI payouts increased sharply in the last half of 2008 (roughly \$10 billion more than in the last half of 2007), the end-of-year balance in 2008 was \$10.7 billion lower than it had been six months earlier (\$29.0 versus \$39.7 billion). Thus employers were taxed at lower rates during 2009 because very little of the late-2008 surge in benefits affected their 2009 tax rates.

The fourth factor, continuing low employment, has affected UI tax revenue in all years after 2007. Employment in the decade prior to the recession grew 1.1 percent per year. Projecting UI covered employment to grow by 1.0 percent per year after 2007 implies that, absent the recession, it would have reached 110.8 million in 2010 whereas actual covered employment was 99.5 million that year. This represents an employment shortfall of 10 percent in 2010. This shortfall has been present since 2008, and, depending upon the pace of future employment growth, it will persist for several years. The depressing effect on tax revenue during 2009, 2010, and 2011 has been at least \$3 billion per year.

Characterizing the preceding four factors as a perfect storm seems appropriate.

Observations on UI Benefits

The cost of UI benefits depends upon three factors: the economy's unemployment rate, the reciprocity rate (the share of the unemployed who receive UI benefits) and the replacement rate (the ratio of weekly benefits to the average weekly wage). The first factor is a concern of macroeconomic management and largely beyond the control of individual states. In contrast, the reciprocity rate and the replacement rate are strongly influenced by state UI statutes and program administration. Both vary widely across the states, especially the reciprocity rate.

At the aggregate level, both the reciprocity rate and the replacement rate display some obvious patterns during the past 60 years. Figure 3 traces five-year averages from 1950 to 2009. First, the reciprocity rate is much more variable than the replacement rate. It decreased noticeably between 1950-1954 and 1965-1969 and again between 1975-1979 and 1985-1989. The decrease during the latter period has been examined by several researchers including the present author. After 1985-1989, however, the reciprocity rate has moved upward and was nearly 10 percentage points higher during 2005-2009 than during 1985-1989. Second, the replacement rate has been much more stable with a total range of between 0.32 and 0.36 over all 12 five-year intervals in Figure 3. The greater relative stability of the replacement rate is even more pronounced in annual data. Reciprocity is much more variable over the business cycle. Third, considering both series, their combined effect on UI costs was greatest during the earliest three periods covered by Figure 3. Most relevant to this discussion, their contributions to benefit costs have not been unusually large in recent years. At the national level, the present funding problem has not arisen from unusually high benefit costs in the regular UI program in recent years.

**Figure 3. UI Reciprocity Rates and Replacement Rates
Five Year Averages for State-Financed UI Programs: 1950-54 to 2005-09**



Source: Reciprocity rates calculated from data published by the Bureau of Labor Statistics and the *Unemployment Insurance Financial Data Handbook*. Replacement rates from the *Unemployment Insurance Financial Data Handbook*.

Note that Figure 3 and the associated discussion refer just to the regular UI program which is state-financed. The Great Recession has been unusual in the level and share of total benefits supported by the federal government. Emergency federal benefits (Emergency Unemployment Compensation of 2008 or EUC08) and Federal-State Extended Benefits (EB) both made large payments during 2009, 2010 and 2011. However, these benefits have been fully financed by the federal partner. Benefit payments under regular UI were high during 2009-2010 but the two-year payout as a percent of payroll was higher during two earlier periods: 1975-1976 and 1982-1983.

UI Tax Revenue

The individual states are mainly responsible for determining the employer payroll taxes that support their UI programs. There are two important federally mandated requirements: each state must have a taxable wage base of at least \$7,000 per worker per year and a maximum tax rate of at least 5.4 percent of taxable wages. Other UI tax provisions are largely determined by the states including the minimum and maximum tax rate, tax rates for new employers, the type of experience rating system that sets employer tax rates, and, crucially, the taxable wage base.

The federal taxable wage base used to collect federal UI taxes has remained at \$7,000 since 1983. While this represented 40 percent of average annual wages in 1983, wage growth has reduced federal taxable wages to 16 percent of total wages in 2009. Most state UI programs have been reluctant to aggressively increase their tax bases much above \$7,000. This year 34 of 53 UI programs have a tax base between \$7,000 and \$15,000 and just 11 have tax bases that exceed \$25,000. In contrast, the Social Security OASDI tax base is \$106,800 this year.

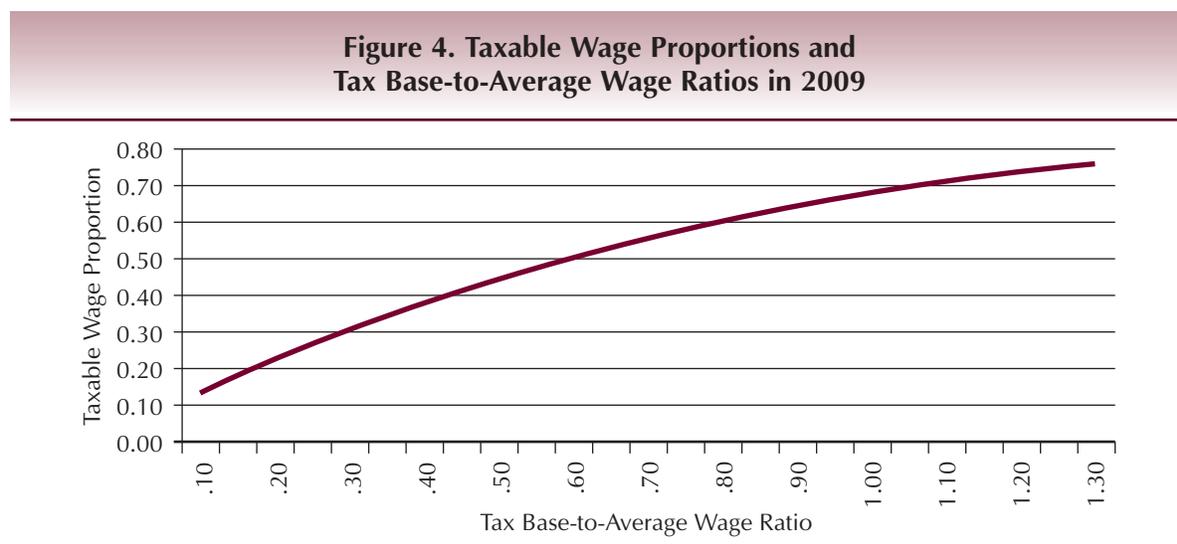
Two factors have been mainly responsible for changing UI tax bases in the states. Sixteen states (and the Virgin Islands) have their tax base indexed to statewide average wages. Their tax bases change automatically each year in response to growth in average annual wages. All 11 UI pro-

grams with tax bases of at least \$25,000 have indexed tax bases. The other factor that has motivated states to increase their tax base has been occurrences of financing problems requiring loans from the U.S. Treasury. In a regression analysis of state tax bases, these two factors explain 70 percent of the variation in state tax base increases between 1985 (shortly after the federal base of \$7,000 was imposed) and 2007 (just prior to the Great Recession). On average, states with indexed tax bases had their 2007-to-1985 tax base ratio roughly double during these 22 years while those with Treasury loans during the period had tax base increases that averaged 29 percent. States with fixed tax bases and no borrowing had generally small or zero tax base increases. Sixteen state UI programs operated with the same tax base in 2007 as in 1985.

In a dynamic economy, low and unchanging tax bases imply that UI programs derive tax revenues from a decreasing share of total covered payroll. Figure 4 illustrates the relationship between the taxable wage proportion (the share of wages that are taxable) and the tax base (the ratio of the tax base to average statewide wages). The figure is based on a representative sample of 17,860 micro earnings records from Ohio in 2009, but a similar relationship holds for all states. As the tax base moves up the earnings distribution, an increased share of total payroll is taxable, but the increases become successively smaller as higher tax bases are reached and the higher bases exceed the annual earnings of a larger and larger share of covered workers.

Figure 4 spans the full range of experiences of UI program tax bases. The highest tax bases are in Hawaii and Idaho which are set at 100 percent of lagged statewide annual earnings. The lowest indexation percentage in 2009 was 40 percent in Oklahoma. The remaining indexed states had indexation percentages between 50 percent and 80 percent of annual earnings.

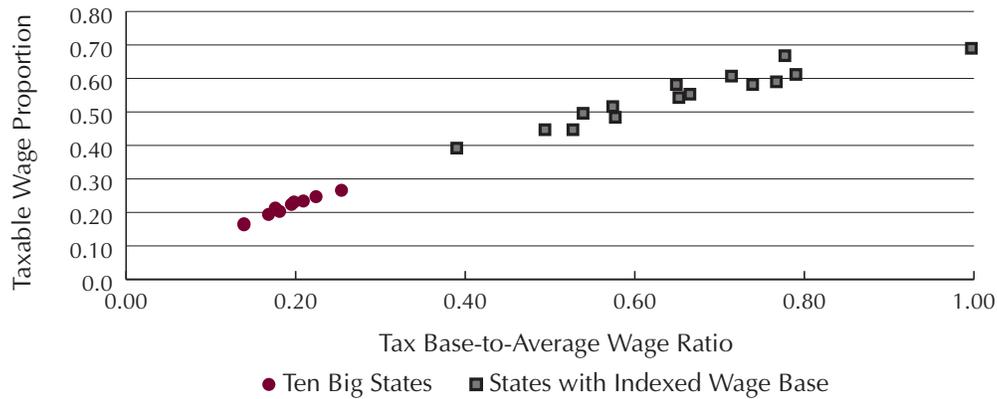
Figure 5 shows actual taxable wage proportions in 2009 for two groups of states: the ten largest (measured by UI employment) non-indexed states and 15 indexed states.² While the states vary widely in their economic structures, average wage levels and other characteristics, the linkage between the tax base-to-average wage ratio and the taxable wage proportion is obvious. The curvature in the relationship, so apparent in Figure 4, is repeated in Figure 5.



Source: Micro UI earnings records from Ohio in 2009.

2 Hawaii had temporarily suspended indexation in 2009.

Figure 5. Taxable Wage Proportions in 2009



Source: U.S. Department of Labor, *Unemployment Insurance Financial Data Handbook*, column (5), (6) and (14).

Figure 5 vividly illustrates the long run effects of UI tax base indexation. The ten large states are bunched to the left (●) with low tax base-to-average wage ratios and taxable wage proportions between 0.16 and 0.27. The contrast with the 15 indexed programs (■) is vivid. All but one (Oklahoma) have tax base-to-average wage ratios of 0.50 or higher and taxable wage proportions between 0.45 and 0.70. Indexation has allowed the tax base in the latter states to grow at the same rate as the growth in statewide average wages.

Tax base indexation is strongly associated with higher tax bases (as shown in Figure 5), larger UI trust fund balances and avoidance of borrowing during the Great Recession. Table 2 provides summary details on all three points for 51 (excluding Puerto Rico and the Virgin Islands) state UI programs. The average tax base in the indexed states of \$27,656 is some 2.7 times the average of \$10,313 in the 35 non-indexed states. The pre-recession reserve ratio multiple in the indexed states was roughly twice the average multiple in the non-indexed states.

Table 2. Comparison of States with and without Indexed UI Tax Bases

| | Number of States | Average Tax Base in 2011 | Reserve Ratio Multiple, 2007 | States Borrowing Since 2007 |
|---------------------------------|------------------|--------------------------|------------------------------|-----------------------------|
| All States | 51 | \$15,704 | 0.538 | 35 |
| States with Indexed Tax Base | 16 | \$27,656 | 0.828 | 6 |
| States without Indexed Tax Base | 35 | \$10,313 | 0.406 | 29 |

Source: All data from the Office of Unemployment Insurance, U.S. Department of Labor. Data are simple averages.

The probability of borrowing from the U.S. Treasury during the Great Recession also varied by indexation status. To date, 35 of the 51 programs have needed loans, a borrowing probability of 0.69. However, only 6 of 16 (or 38 percent) indexed states have borrowed compared 29 of 35 (or 83 percent) non-indexed states. Table 2 shows indexed programs entered the recession with more adequate reserves and they fared much better in terms of borrowing.³ Of the \$40.3 billion of loans outstanding at the end of May 2011, only \$5.2 billion (13 percent) was owed by the six indexed states that have borrowed. Their share in August 2011 was also 13 percent.

Researchers and policymakers often look for a silver bullet to solve an important social problem. While indexation the UI taxable wage may not be a silver bullet, it appears to perform at least as well as a stainless steel bullet for addressing the UI financing problem

Total UI tax revenue depends upon the average effective tax rate on taxable wages as well as the taxable wage proportion. During the Great Recession average UI tax rates have increased, but the increases have been generally modest. The average effective tax rate on taxable payroll for the four calendar years 2007 to 2010 was 2.44, 2.27, 2.29 and 2.90 percent respectively. The effective rate decreased between 2007 and 2008 and (for reasons of timing in 2008 as discussed previously) did not increase in 2009. Thus for the two years 2009 and 2010 UI taxes averaged 0.71 percent of total payroll while state-financed regular benefits for the same two years averaged 1.44 percent.

The modest response of aggregate UI taxes has extended into 2011. For the first five months, UI taxes totaled 25 percent more than for the same period in 2010 (\$27.9 versus \$22.3 billion). The increase in tax revenue of 2011 coupled with a continuing decrease in benefit payments has meant that the aggregate trust fund balance increased more during the first five months of 2011 than during the same period in 2010. During these five months net reserves decreased by \$5.3 billion in 2010 while they increased by \$9.9 billion during 2011. However, \$40.3 billion in loans were still outstanding at the end of May 2011 and \$37.0 billion was owed at the end of August. Many states, especially most large states, will continue to have debts for several years. Restoring trust fund balances to more adequate levels will undoubtedly span several additional years even after current loans from the Treasury have been fully repaid.

Proposals and Options to Improve UI Financing

Individual states have responded to their trust fund deficits in a variety of ways. To date five distinct responses can be identified.

- 1) Some states have allowed UI taxes to increase fully in line with existing UI tax statutes. Employers with bad experience (a majority in several states) have moved along existing tax rate schedules to higher tax rates and to higher tax rate schedules as specified by their tax statutes.
- 2) Some states enacted a combination of higher taxes and/or reduced benefits during 2009-2011. These actions in states such as Hawaii, New Hampshire, South Dakota, Tennessee and West Virginia allowed them to avoid borrowing altogether or to limit borrowing to small amounts for brief periods. One innovation common to these states was to impose quarterly solvency taxes that end when designated trust fund thresholds are achieved.

3 Small states have generally maintained higher reserves in recent years when compared to large states. As a result, the simple average of the 51 reserve ratio multiples in Table 2 is 0.538, higher than the 0.356 based on the national aggregate which reflects weighting according to state size.

- 3) Texas issued debt instruments in the private securities market at the end of 2010, an issuance that totaled nearly \$2 billion. Idaho borrowed \$200 million in the private bond market in August 2011. Several other states have considered this financing option and some may follow this path in 2012.
- 4) Several states, in particular the majority of the largest states, have not yet responded by raising UI taxes. California, New York, Florida, Illinois, Pennsylvania, Ohio, Michigan, New Jersey, North Carolina and Georgia provide ten examples of states that have not acted to increase taxes or have acted to prevent tax increases slated to become operative under state's existing UI tax statutes. For these ten states the maximum tax rate in 2011 is less than 2.0 percentage points higher than in 2008 and their tax base has changed little or not at all. Some of these states (Florida, Michigan and Pennsylvania) have partially addressed their solvency problem by reducing regular UI benefits through legislation enacted in 2011. At the end of August 2011 all ten of these large states had loans from the Treasury that equaled at least 0.5 percent of covered payroll.
- 5) Some states have enacted bills in 2011 to restrict regular UI benefit eligibility. Arkansas, Florida, Michigan, Missouri, Pennsylvania and South Carolina have reduced potential benefit duration below 26 weeks. Prior to these reductions, duration maximums of 26 weeks or more had been place in all state UI programs since the late 1950s. Benefit reductions will undoubtedly be considered by several other states next year.

Most states with outstanding loans seem to be waiting for new federal policy actions. They have been hoping for federal legislation to further postpone the interest charges on outstanding loans and increases in FUTA tax credit offsets both of which are operative in 2011. The U.S. Treasury website indicates more than \$1.0 billion in interest charges accrued during the first seven months of 2011. As noted previously, 24 states are subject to FUTA credit offsets during 2011. Absent new legislation, their employers will pay 0.3 percent in additional federal UI taxes this year with all employers paying the same flat rate (0.3 percent in 21 of 24 states).

One piece of federal legislation introduced this year is the "Unemployment Insurance Solvency Act of 2011," Senate Bill S.386.IS sponsored by Senators Durbin, Reed, and Brown. The proposed legislation offers the states a quid-pro-quo: deferral and reduction of debt repayment obligations in return for new state legislation to improve long run solvency. States are encouraged to submit plans that specify how they will improve trust fund solvency during the upcoming seven years. States with acceptable plans will have a fraction of their outstanding debts forgiven in equal annual installments that extend over the next seven years.

To be deemed acceptable, a debtor state's principal abatement plan must maintain the benefit provisions of its current UI law.⁴ This requirement means that the improvement in long run solvency must come from increased UI taxes. The states determine how the tax increases are determined, but one element must be an increase in the taxable wage base. The state's taxable wage base must be to at least \$15,000 by 2014, and increases in subsequent years tied to the growth in average wages nationwide. Acceptable plans must improve solvency sufficiently to reach a reserve ratio multiple of at least 1.0 by the end of the seven years. The federal partner determines if the state's plan is acceptable or not. For states that enact

4 This is specified to mean four things: i) no change in the calculation of the weekly benefit amount (WBA) that would reduce the WBA, ii) no restriction on UI eligibility, iii) no reduction in the maximum weekly benefit and iv) no other change that effectively reduces UI benefits relative to current law.

acceptable plans, the principal on their outstanding loan balances would be reduced proportionately by either 0.2, 0.4 or 0.6 with the proportion dependent on the state's Medicaid matching proportion. This proportion provides larger financial rewards to states with lower statewide average incomes. The principal abatements are to be spread proportionately over the years the plan is operative.

As discussed previously, not all state UI programs experienced financing problems during the Great Recession. S.386.IS offers financial rewards to the solvent programs. States that achieve a reserve ratio multiple of 1.0 throughout a given future year receive a higher interest rate of 0.5 percent (50 basis points) on their UI trust fund balance. The added interest income can be used for UI administration as well as paying UI benefits. These states would also pay a lower FUTA tax rate during the same future years.⁵ These rewards provide a financial incentive to achieve and maintain large UI trust fund balances.

States that enact acceptable principal abatement plans will have the interest charges on their outstanding loans forgiven during 2011 and 2012. They will also enjoy a two-year deferral of FUTA credit offsets.

A second legislative proposal that affects UI is the President's budget proposal for fiscal year 2012. This shares three elements with S.386.IS: 1) deferral of interest on UI loans during 2011 and 2012, 2) deferral of FUTA credit offsets during 2011 and 2012 and 3) an increase in the federal UI tax base to \$15,000 in 2014 and indexation of the tax base in later years. To date, neither bill has passed either the House or the Senate. Thus the states are presently facing both interest charges on loans and FUTA credit offsets this year.

A third legislative proposal, the "Jobs, Opportunity, Benefits and Services Act of 2011," House Bill H.R. 1745 sponsored by Representatives Camp, Davis, and Berg, was introduced in the House of Representatives in May 2011. The authors indicate the proposed legislation has two purposes: to reform unemployment insurance and address funding shortfall in the federal unemployment insurance trust funds. The bill proposed strengthening of job search requirements and mandatory participation in employment services for claimants. It also overrides existing regulations that require higher state UI taxes when state trust funds are depleted. It proposes a federal transfer of \$31 billion into state UI trust funds during fiscal years 2011 and 2012. These new monies can be used by states in three possible ways: 1) to pay UI benefits, 2) to repay Title XII loans and 3) to increase the provision of employment services to claimants. States can decide the allocation of monies among these three uses. The legislation also proposed shortening the duration of EUC and EB benefit entitlements by six months, to early July 2011. In effect, this bill places the burden of adjustment on UI claimants (through increased eligibility requirements and benefit reductions) and the U.S. Treasury (through the \$31 billion disbursement). It also potentially relieves employers of some of the future costs of supporting the regular UI program as debt repayment is one of the possible uses of the \$31 billion federal disbursement. The bill was passed by the House of Representatives but has not advanced in the Senate. Compared to the Durbin and Obama Administration proposals, the Camp proposal would bring about smaller solvency adjustments by the states especially in the long-run as it actually would restrain the growth of future state UI tax revenue.

The current financing situation is unprecedented in the scale of state UI debts. With so many states in debt, the prospect for enacting some form of financial relief would seem likely. However, current concerns about the scale of the federal budget deficit and the national debt would likely inhibit any action that would provide short term fiscal relief to state UI programs.

5 The reduction would be from 6.2 percent of federal taxable wages to 6.0 percent while the \$7,000 federal tax base is operative and from 5.78 percent to 5.68 percent in 2014 and later years under the higher federal tax base.

From the earlier discussion, it is clear that higher tax bases are associated with improved long run solvency. Given the demonstrated reluctance of states to raise their tax bases, it seems that the easiest route to improved solvency is to increase the federal tax base as proposed under S.386.IS and the President's FY2012 Budget Request. One question about the proposed increase to \$15,000 in 2014 is its sufficiency in addressing the long run financing problem in the states. Also obvious is the potential need to increase the maximum tax rate levied by the states on taxable wages. In 2011 there are still seven states where the maximum tax rate is 5.4 percent of taxable wages, including three states with outstanding loans from the Treasury.

Given the large scale of the financing problem and the reluctance of many states to take aggressive actions to improve solvency, it may be the time to consider broader reforms than are usually discussed. The current mixed federal-state arrangement reflects an accident of history from the 1930s when the existence of a few state UI programs, e.g., Ohio and Wisconsin, influenced the structure of the UI program included in the Social Security Act of 1935. If the states are incapable of providing adequate financing, it may be time to consider a larger federal role in UI.

Figure 1 showed that in the six years after 1983, the states made large strides in restoring their UI trust funds to solvency. The aggregate year-end net trust fund balance increased by more than \$42 billion between 1983 and 1989. Are the states capable of similar actions in the present decade to restore trust fund balances? If federal solvency legislation is not enacted, we will watch this evolution unfold during the next five to eight years. If the states do not restore trust fund balances, it could be time for the federal partner to undertake a greatly expanded role in financing UI. Should this happen, the United States would join nearly all other economies worldwide (with China a notable exception) in operating a unitary or national program of unemployment insurance.

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