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H.R. 3684, THE "EMPLOYMENT SECURITY FINANCING ACT OF 1998"

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

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H.R. 3684, THE "EMPLOYMENT SECURITY FINANCING ACT OF 1998"

TUESDAY, JUNE 23, 1998

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:10 p.m., in room B–318, Rayburn House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
June 16, 1998
No. HR-15

CONTACT: (202) 225-1025

Shaw Announces Hearing on H.R. 3684, the "Employment Security Financing Act of 1998"

Congressman E. Clay Shaw, Jr., (R-FL), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on H.R. 3684, the "Employment Security Financing Act of 1998." **The hearing will take place on Tuesday, June 23, 1998, in room B-318 Rayburn House Office Building, beginning at 3:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include State government and unemployment officials, business leaders, and other experts in the administration of the Federal-State unemployment insurance and employment security programs. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Federal-State unemployment insurance (UI) system provides temporary benefits to individuals with a recent work history who become involuntarily unemployed. Federal taxes generally support the administrative expenses of the UI system, along with the cost of providing employment services (ES) that assist individuals in returning to the workforce; State taxes support unemployment benefits.

Increased skepticism about the efficiency of the system, and especially its administration, has been one of several reasons fueling calls for reform. In recent years, various States, employer groups, and think tanks have developed proposals to reform the administrative financing of the system. Chairman Shaw has introduced a reform proposal, H.R. 3684, designed to increase State flexibility and accountability in fulfilling the UI/ES system's mission. Proponents of this approach argue that it would cut business paperwork, improve efficiency in labor markets, and finance more and better employment services for jobless workers, speeding their return to work and allowing States to increase unemployment benefits or reduce payroll taxes.

H.R. 3684 proposes numerous changes aimed at improving the administration and efficiency of the UI program. As contemplated by the legislation, little would change from a recipient standpoint. Benefits would continue to be set by States and paid for with State taxes, as part of a national system that meets due process standards. However States, aided with new Federal funds, would begin collecting all taxes that support the system, cutting business paperwork and unemployment tax filings in half. In addition, Federal unemployment taxes would return to their historic levels with the elimination of the 0.2 percent Federal Unemployment Tax Act surtax in 2004.

As contemplated under the bill, service would likely improve as States take a keener interest in getting the jobless back to work. The bill would envision that as States, encouraged by administrative financing changes phased in beginning in 2003, build up trust accounts through improved collections, greater efficiency, and quicker returns to work, they would have more funds to expand employment services or reduce State payroll taxes or both. States with small workforces would receive special payments to ensure that they could continue to meet local needs. Current program features providing extended benefits and special assistance for veterans and the disabled would remain in place.

(MORE)

The Administration has also offered a proposal, introduced by Representatives Levin and English, that is aimed at assuring that the current UI program fulfills its mission and remains on sound financial footing. This proposal, H.R. 3697, the "Unemployment Compensation Amendment Act of 1998," would ensure extended UI benefits "trigger on" appropriately during a recession, encourage States to improve the solvency of their respective unemployment trust funds, help States voluntarily improve their methods for calculating the base periods used for determining UI eligibility, and provide more administrative funding for the States.

In announcing the hearing, Chairman Shaw stated: "This Subcommittee should consider ways to improve the nation's employment security system to benefit workers and employers and especially jobless Americans. H.R. 3684 has broad support among States and the business community because it would enhance program efficiency, cut payroll taxes, and get the jobless back to work sooner. The time is now -- when unemployment is low and Federal coffers are full -- to consider changes to help us better respond to workers' needs in future recessions."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label*, by the close of business, Wednesday, July 8, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Human Resources office, room B-317 Rayburn House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

(MORE)

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****

Chairman SHAW. The Subcommittee on Human Resources will come to order.

Keeping the Nation's unemployment insurance system operating effectively is important to more than 100 million employees, to millions of employers, and to the strength and vitality of the United States' economy. Yet, despite this critical mission, today less than 60 cents out of every dollar in Federal taxes collected to run the unemployment insurance system is used for its intended purpose, and that is to administer benefits and get the jobless back to work.

Florida's Labor Secretary, Doug Jamerson will testify that in 1996 about 35 cents per dollar in Federal taxes was returned to the State of Florida. In fact, the difference between Federal unemployment taxes paid by Florida businesses from 1991 to 1996 and what my State received back from Washington totals more than $1 billion.

Florida is not alone. Nationally, over the next 5 years, more than $10 billion in Federal unemployment taxes will probably get lost in Washington instead of helping jobless workers. When jobless workers don't benefit from billions of dollars in unemployment taxes collected specifically for them, something is terribly wrong.

That's one reason why working with a bipartisan coalition of employers and 27 States, I introduced H.R. 3684, the Employment Security Financing Act of 1998. This legislation's goal is simple—to get jobless Americans back to work sooner.

H.R. 3684 is endorsed by the United States Chamber of Commerce, the National Association of Manufacturers, the National Restaurant Association, and even the National Broiler Council. Now, if the Nation's fried chicken lobby is on our side, who can possibly be against us at this point? [Laughter.]

For recipients, little would change; benefits would remain set by States as part of a national system; small States would retain extra Federal payments; and extended benefits and special assistance for veterans and the disabled would continue. But States would collect all taxes that support the system, cutting business paperwork and tax filings in half. More employment services would help the jobless find work sooner. And Federal unemployment taxes would fall with the end of the .02 percent surtax, which its defenders label "temporary" even though it has been around for the last 22 years.

This Subcommittee should consider ways to improve the unemployment system to benefit workers, employers, and especially jobless Americans. But we have to acknowledge the heart of the current problem—a Washington-designed system that taxes too much and helps jobless Americans too little. The funds are there. But as with welfare reform, we need to repair an outdated system so it works better for jobless Americans and for their families.

[The opening statement follows:]

Opening Statement of Chairman Clay Shaw
June 23, 1998

Keeping the nation's unemployment insurance system operating effectively is important to more than 100 million employees, to millions of employers, and to the strength and vitality of the U.S. economy.

Yet despite this important mission, today less than 60 cents out of every dollar in federal taxes collected to run the unemployment insurance system is used for its intended purpose -- to administer benefits and get the jobless back to work. Florida's Labor Secretary Doug Jamerson will testify that in 1996 about 35 cents per dollar in federal taxes was returned to Florida. In fact, the difference between federal unemployment taxes paid by Florida businesses from 1991 to 1996 and what my state received back from Washington totals more than $1 billion.

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Chairman SHAW. Now, I will recognize Mr. Levin for his opening statement.

Mr. LEVIN. Thank you, Mr. Chairman. Let me start by saying that I agree that we need to reform a system, the Nation's unemployment compensation system that was enacted over 60 years ago to help provide assistance to laid off workers. The strength of today's economy provides us with a good opportunity to begin making some of these changes or to put it another way, to fix the roof while the sun is shining.

However, I have deep concerns that the legislation that's being proposed, H.R. 3684, would do much more harm than good. Rather than fixing the roof, it might put a huge hole in it. First, the legislation ignores many of the current problems faced by our unemployment comp system, such as the decline in the number of unemployed Americans receiving UI, a figure that I think is shocking, and the threatened solvency of the State unemployment trust funds. To remain silent when the percentage of workers qualifying for unemployment compensation has declined from nearly 50 percent in the 1950's to about 35 percent today is a mistake; and to ignore the fact that 22 States have insufficient reserves in their unemployment trust funds to weather a sustained recession is equally unwise.

Second, the bill would create new problems for our unemployment comp system. For example, H.R. 3684 would eliminate the current benefit for extended unemployment benefits, EB, without proposing a reliable replacement. It's true the legislation calls on States to establish their own EB programs, but there is no enforcement mechanism on the Federal level to ensure they do so. This could place dislocated workers in jeopardy during severe economic downturns. And I might add that I think this is national, not only a State problem because in times of downturn, people move from one State to another.

Furthermore, H.R. 3684 could undermine the insurance principle of shared risk, under which the current UI system pays States based on their administrative workloads, not on the amount of taxes paid in that State. Under this bill, it would not matter if one State has an unemployment rate of 3 percent and another has an unemployment rate of 10 percent.

I believe that we can build upon the current State/Federal partnership rather than ripping it apart. After all, unemployment is a national problem requiring shared responsibility and oversight between the States and the Federal Government.

Therefore, along with Mr. English and Mr. Rangel, I have introduced legislation proposed by the administration to make improvements to the current unemployment comp system while still maintaining the State/Federal partnership. This legislation, H.R. 3697, would help States voluntarily improve UI coverage among low-wage workers, encourage States to improve the solvency of their unemployment trust funds, establish a more accurate and more equitable trigger for extended unemployment benefits, and provide new supplemental funding to help States with their administrative costs.

On this last issue, let me explain that our legislation would provide an additional $106 million in mandatory funding for State ad-

ministrative expenses in Fiscal Year 1999, as well as additional mandatory funding in subsequent years.

Let me also add in terms of Federal/State partnership, it seems to me that we need to step back and to take an even broader look at unemployment compensation in 1998. There's been a lot of change in recent years, perhaps in recent decades, as to the nature of unemployment. Fewer and fewer people are temporarily laid off and more and more are permanently laid off. And it may well be that we need to look at ways to integrate unemployment compensation—or unemployment with training and re-training programs. If we're going to do that, I would think on a Federal/State partnership basis, that the notion of devolution could work against the need to adjust unemployment—the response to unemployment as it's occurring in 1998 and 1999 as compared to 1978 or 1968.

Mr. Chairman, I look forward to hearing from today's witnesses, and to an open discussion about our unemployment compensation system.

Thank you.

[The opening statement follows:]

SANDER LEVIN
SUBCOMMITTEE ON HUMAN RESOURCES

Hearing on Unemployment Insurance
June 23, 1998

Mr. Chairman, I agree we should reform an unemployment compensation system that was enacted over sixty years ago to help provide assistance to laid-off workers. The strength of today's economy provides us with a good opportunity to begin making some of these changes — or to put it another way, fix the roof while the sun is shining.

However, I have deep concerns that the legislation you are proposing (HR 3684) will do much more harm than good. Rather than fixing the roof, it will put a huge hole in it.

First, this legislation ignores many of the current problems faced by our unemployment compensation system, such as the decline in the number of unemployed Americans receiving UI and the threatened solvency of the state unemployment trust funds. To remain silent when the percentage of workers qualifying for unemployment compensation has declined from nearly 50% in the 1950's to about 35% today is a mistake. And to ignore the fact that 22 states have insufficient reserves in their unemployment trust funds to weather a sustained

recession is equally unwise.

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Furthermore, HR 3684 would undermine the insurance principle of shared risk, under which the current UI system pays states based on their administrative workloads, not on the amount of taxes paid in that State. Under this bill, it will not matter if one state has an unemployment rate of 3% and another has an unemployment rate of 10%.

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unemployment compensation system while still maintaining a state-federal partnership. This legislation (HR 3697) would: help states voluntarily improve UI coverage among low-wage workers; encourage states to improve the solvency of their unemployment trust funds; establish a more accurate and more equitable "trigger" for extended unemployment benefits; and provide new supplemental funding to help states with their administrative costs. On this last issue, let me explain that our legislation would provide an additional $106 million in mandatory funding for state administrative expenses in FY 1999, as well as additional mandatory funding in subsequent years.

Mr. Chairman, I look forward to hearing from today's witnesses and to an open discussion about our unemployment compensation system. Thank you.

Chairman SHAW. Thank you, Sander.

Our first witness today is Grace Kilbane, who is the Director of the Unemployment Insurance Service, United States Department of Labor.

Welcome. We have your full statement which will be placed in the record in full, and you may proceed and summarize as you see fit.

STATEMENT OF GRACE KILBANE, DIRECTOR, UNEMPLOYMENT INSURANCE SERVICE, U.S. DEPARTMENT OF LABOR

Ms. KILBANE. Thank you, Mr. Chairman and Members of the subcommittee, for this opportunity to testify before you today on the Employment Security Financing Act of 1998. First of all, I would really like to applaud the coalition and this bill's objective to both reform the funding for employment security, as well as to increase the funding and the return on FUTA for the employment security system.

However, we do have some concerns that we also would like to share with you about this bill today from the administration's perspective.

I also would like to commend you, the members of this subcommittee, for taking your time to look at these programs during this good economy. This is the best time to look at the unemployment insurance program so that we're ready if and when the economy takes a downturn.

In the interest of time, I would like to do two things today, one is to summarize what our concerns are with this bill, and, secondly, to present what the administration's proposals are regarding these issues.

First of all, the stated primary purpose of this bill, H.R. 3684, is to remedy the insufficient administrative funds that are in the system. The concern that we have is that the solution that is proposed to this major problem, which is to transfer the funds from Congress to the States, does not guarantee the problem will be fixed. Most State legislatures meet for only a portion of the year, and six State legislatures meet biennially. There's no guarantee in this legislation that the States will be able to respond quickly to economic downturns at the State level: either to unforeseen economic downturns or even those that are caused by large natural disasters, which we have seen particularly in small States.

Transferring funding from Congress to States, too, has also brought some concerns to some of our other agencies. Our Veterans Employment and Training Service is concerned that States could make decisions to not fund veterans' programs with no guarantees or requirements that they be funded. And our Bureau of Labor Statistics is concerned that there is no guarantee that the States would be sufficiently funding these programs if they're funded at the State level—there's some question about whether that remains a Federal or State responsibility.

In addition to having the States appropriate funds instead of Congress, the bill also transfers the responsibility for collecting the Federal unemployment tax, or FUTA, from the IRS to the States. We think that we need to take a close look at this because having the States collect Federal revenue, and having their legislatures

then appropriate Federal dollars, with no Federal requirements, no guidelines, no standards, nor any kind of Federal requirements, actually flies in the face of the Government Performance and Results Act, which Congress passed a few years ago in order to make sure that we were spending Federal dollars wisely and achieving outcomes.

We would like to see other options considered in terms of how to restructure the funding of this. For example, maybe the funding should be totally switched to the mandatory side of the budget, that's where we pay benefits. We pay $22 billion a year of benefits right now. Perhaps, the administrative dollars should be switched there. Another idea that has been considered in the past is to create a permanent cap adjustment on the discretionary side so that you could fund these programs based on workload, and when workload went up, you'd have sufficient funding to pay for it. A third idea is that if there is a public policy—a good public policy reason to transfer the administration to the States, that is, the States being responsible for administration of these programs, then perhaps we should consider a State-based administrative tax, just like a State-based benefits tax that the States would collect together and keep a reduced FUTA tax for Federal activities that Congress would still appropriate.

This bill basically restructures our current trust fund, and eliminates the three current Federal accounts and creates 53 specific State accounts. In doing that, it creates a Federal administrative account for Federal activities. It limits to Congress for appropriation to the Federal Government 2 percent of the Federal funds, or the FUTA funds, collected. So the States keep 98 percent (including 2 percent small State set-aside) of the money and they give 2 percent to the Federal Government. This would produce right now about $125 million a year. For the Department of Labor administration alone this year, it cost $195 million. Current Federal activities would be cut by 36 percent by this proposal.

Basically, the Secretary of Labor's responsibilities stay pretty much the same under this bill. Congress would be limited to only the 2 percent appropriation. And, in addition, the 2 percent in this bill would cover the IRS activities which would be an additional amount of money, we're not sure how much. Currently, it costs a little over $100 million for the IRS but they wouldn't be collecting the taxes but would still be maintaining accounts. So this would even further underfund Federal activities.

Under H.R. 3684, the Extended Benefit Program would be given over to the States to be administered solely by the States. So the whole Federal partnership—State partnership for extending benefits when the economy starts going down in certain areas or regions would be eliminated. We would have no special funding mechanism but for EB. Congress would be faced with enacting special compensation programs, extended unemployment compensation programs.

And if we look at our experience in the last recession, when Congress did this in the 1990's, it cost $28.5 billion in Federal funds in order to enact these programs, $12 billion of which was funded by FUTA, which we will be eliminating in this proposal, and $16.5

billion of which was funded by general revenue which had to be offset.

We also believe that this proposal weakens State accountability for performance. The bill does require States to determine what they want to achieve and then report annually to the Governor. There's no requirement that these be comparable State by State, so we could look at the country and see what the performance is.

Finally, looking at this bill in an era of more and more multinational corporations and global economies, we just have to wonder if it makes sense to reduce our ability to respond as a nation by reducing our Federal and national roles.

In terms of the administration, we think that in order to enact reform and strengthen the unemployment insurance program, we need to address three key issues:

The first one is recipiency, which Mr. Levin referred to earlier in his remarks;

Secondly, recession readiness; and

Finally, administrative funding, which is where we agree with the overall objective of H.R. 3684.

If we could look at recipiency for a moment, and we do have some charts over here, which I've also made available to you, copies for the record, you can see that those able to receive unemployment compensation have been steadily trending downward, or eroding since the 1950's. It used to be about half unemployed workers who could get unemployment insurance. Now, nationally, about 36 percent can in 1990, and that's what that chart shows you. In some States, it's under 25 percent, or only one in four unemployed workers receive benefits.

If we could look at the next chart, we know, and studies have shown, that this downward trend in recipiency has negatively impacted the program's ability both to help individuals with their economic stabilization during periods of joblessness, as well as the economy. And what this chart shows you is that post-World War II, which is about 1945 there on the chart, you'll see that the squiggles, the up and down squiggles in terms of change in our Gross National Product, were stabilized or smoothed so to speak. Before that, the swings in our economy were much broader. And what economists have agreed to is that the unemployment insurance program, as well as other fiscal activities that have been taken, have in part contributed to smoothing out the economic cycles in our economy.

The second goal is recession readiness and what we're concerned about there is during the last recession in this country, in the early 1990's, only nine States triggered on to extended benefits, which caused Congress to act with a national program for all States.

Also, we're concerned about State trust fund levels, or solvency levels. These levels are below where they should be in this recovery of the economy, in our opinion, and we're concerned that a large economic downturn would cause major State borrowing.

And, finally, we believe that we need to pay attention to administrative funding which, again, is also the purpose of H.R. 3684. Since Fiscal Year 1995, appropriations for the unemployment insurance program have remained static, and have not accounted for increases in workload or inflation. The Employment Service fund-

ing has been steadily cut since 1984, hindering its ability to re-employ workers quickly. In 1997, States had to pitch in $200 million of their own money and so we see evidence of this.

Our approach to reform is, therefore, in our budget request, which the President set in motion. For 1999, we set in motion a plan to reform the employment securities system. This is a two phase strategy that we have put in place. The first phase is a bill, H.R. 3697, which was introduced by Representatives Levin, English, and Rangel to provide incentives to strengthen the unemployment insurance program in these areas: recipiency, recession readiness, and administrative funding; and to really provide a down payment for further and larger discussions of how to permanently reform this program.

H.R. 3697 would provide $20 million in each of the next three fiscal years for States to install an alternative base period. If every State did this, this would help an additional 450,000 people to become eligible for benefits today. Mostly, these are low-wage workers and this would increase recipiency by 6 to 8 percent and start reversing that trend that we saw on the first chart.

In terms of recession readiness, H.R. 3697 would prepare the Unemployment Insurance Program for a recession. It would strengthen the Extended Benefit Program by revising the program triggers so that the program could respond during a recession.

And if we could look at the next chart real quickly, this will show you that if the Adminstration proposed law was in place in the 1990's recession, it would have cost the country a total of $7.2 billion and it would have triggered on in 29 States. Instead, the triggers only happened in nine States, shown by that really skinny color on the "current law" bar, and Congress enacted five extensions of extended unemployment compensation for a total cost of $28.5 billion. We believe that if the program was more responsive, it would go on quicker, it would be more effective in the right places, and it would cost less money.

We also provide incentives in this bill for helping to improve the solvency of the trust fund. And, again, if we look at the next chart, you will see a——

Chairman SHAW. Ms. Kilbane, could you go ahead and wrap up?

Ms. KILBANE. Yes.

Chairman SHAW. You're about three times your five minutes right now.

Ms. KILBANE. Okay. Essentially, if I could just move on to the end, basically we would also fix administrative funding by adding some additional funds. And the bill also proposes to extend the Self-Employment Assistance Program, which is due to expire December 8th—10 States currently have that program.

One of the issues that we have in both extended benefits and administrative financing is return on FUTA. And if I could just show our final two charts here, return on FUTA is more than administrative dollars. It also includes extended benefits and loans; it does not include general revenue for emergency programs. If you would look at, here's an example, 1989, which was a pretty good economic time for our country—almost every State got back less than 70 percent of their FUTA dollars that they put in. But if you look a few years later, just three years later, to 1992, when we were, in fact,

in a recession, you will see that almost every State in the country got back more than the dollars that it put into FUTA funding. We need more administrative funding and we need more FUTA funding for extended benefits when our workload goes high, when the economy goes down.

I would like to thank you for your time and this concludes my formal remarks, Mr. Chairman.

[The proposed statement and attachments follow:]

STATEMENT OF GRACE A. KILBANE
DIRECTOR
UNEMPLOYMENT INSURANCE SERVICE
EMPLOYMENT AND TRAINING ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

June 23, 1998

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify on the Employment Security Financing Act of 1998 (H.R. 3684) and its impact on the unemployment insurance (UI) program. There are several significant issues that need to be considered in order to ensure that the Employment Security system fulfills its mission in today's changing economy and that it remains on sound financial footing for the 21st Century. As I will discuss below, the Administration has proposed legislation to begin to address some of these issues and initiated a broad dialogue on reform of the UI program.

As you know, the bill that is the focus of today's hearing, H.R. 3684, was developed by the Coalition for Employment Security Financing Reform, essentially to address administrative funding problems. I applaud the bill's overall objective to reform the funding structure of the Employment Security system. The Department of Labor, however, has serious concerns about

the proposal as well as important issues which should be addressed, but are not included in the bill.

BACKGROUND

Before turning to H.R. 3684, I would like to take a moment to provide some background information on the UI program. Enacted over sixty years ago as a Federal-State partnership, UI has been a major source of temporary income support for laid-off workers who are seeking work. In addition, for over sixty years, the Employment Service (ES) program has served to assist workers in finding new jobs. Since the advent of both programs, the economy has changed, the workforce has changed, the workplace has changed and the way we work has changed, affecting both workers and businesses. Research suggests that these changes may be impacting the UI program in unanticipated ways.

UI coverage has expanded so that 97 percent of all wage earners are now covered by the UI program. However, UI recipiency has been declining, which means that a lower percentage of the unemployed receive benefits. Research attributes the decline in recipiency to a number of factors. Changes in the labor market, such as geographic shifts and sectoral shifts from manufacturing to the services sector, are part of the explanation. But State law changes that restrict program eligibility and lower wage replacement rates also play a role. Declining recipiency means that the UI program has lost some of its effectiveness as an automatic economic stabilizer.

Despite these declines in UI recipiency, research indicates potential financial problems in the UI system. Projections show that State borrowing during the next recession will be much higher than it was in the 1980's because of relatively lower State trust fund reserves. Now, while the economy is strong and unemployment is low, is an opportune time to reform and strengthen the UI program.

KEY ISSUES

Reform is needed to strengthen the UI program in three (3) key areas: recipiency, recession readiness, and administrative funding.

Recipiency -- The recipiency rate for unemployment compensation has dropped from 49% in the 1950's to an average 35% in the 1990's and is below 20% in some States. That means that the program is currently serving proportionately fewer unemployed workers than in the past. This harms the program's ability to help workers who have lost their jobs, as well as weakens its role as a stabilizer in the economy.

Recession Readiness -- Recessions are experienced at the State and Regional levels and the UI program should work effectively at those levels. However, during the last recession, only nine (9) States "triggered on" to the Extended Benefit (EB) program -- the program established to provide additional benefits during periods of economic downturn. State trust fund levels, which are the amount of funds States have available to pay benefits, are also a concern. Even though we now enjoy a period of very low unemployment, estimates show that an economic downturn of

the magnitude of the 1980-82 recession could result in $20-$25 *billion* of State borrowing of Federal funds to cover UI benefits.

Administrative Funding -- Funding for the Employment Security system has been steadily declining. Since fiscal year (FY) 1995, the UI appropriation has remained static, ignoring the increased costs of inflation and workload growth associated with increases in the number of subject employers and growth in the civilian labor force. Consequently, activities that are needed to preserve the integrity of the Trust Fund are curtailed. These include prevention, detection, and collection of benefit overpayments, as well as tax audits and collections of delinquencies. The reduction of these activities costs the Trust Fund approximately $160 million per year.

The Employment Service (ES) has also experienced steady cuts in funding. Since 1984, when adjusted for inflation, Wagner-Peyser grants to States to provide job finding and placement services to UI claimants and other job seekers have been reduced substantially. Among other impacts, this affects services to help unemployed workers return to work quickly, contributing to a higher average duration of unemployment (14.8 weeks) during this good economy and to a higher rate of exhaustion (33%) of benefits than is typical at this stage of the economic cycle. The Administration's approach has been to increase funding to the system through one-stop grants. States have attempted to compensate for the under-funding by supplementing Federal funding of the Employment Security system with approximately $200 million in FY 1997, about $89 million for UI and approximately $111 million for ES.

These issues and program trends indicate that it is time to address both funding and program reform to ensure that the fundamental principles of the UI program are met.

UI PRINCIPLES

The major components of the UI program involve payment of benefits, funding of benefits, and administration of the program. Accordingly, a fundamental principle of the UI program is that benefits should provide an adequate economic cushion while recipients search for suitable work. For the program to provide macroeconomic stabilization, these benefits must be available to a sufficiently large portion of workers who lose their jobs.

A basic benefit funding principle is that the UI program be self-financing. This means that funds should be accumulated during periods of economic growth so that they will be available to pay benefits during economic downturns. This self-financing principle also has a Federal component. Federal UI taxes build up balances to pay the Federal share (50%) of the EB program and to provide repayable advances to States that have become insolvent. In both cases, Federal funds are available to all States without regard to how much Federal tax the employers in a State have paid.

In terms of program administration, States and the Department of Labor share responsibilities. Each State operates its UI program in accordance with its law, but State law is required to conform with certain basic provisions of Federal law. Administrative funding for the UI program and 97 percent of funding for ES programs comes from Federal UI taxes. Congress

appropriates administrative funds which are allocated based on individual State needs without regard to the amount of taxes paid by the employers in a State. Federal UI taxes also pay Federal administrative costs.

COMMENTS ON H.R. 3684

I would like to turn to our concerns with H.R. 3684. The stated primary purpose of the bill is to remedy insufficient funding of Employment Security programs by Congress. I certainly agree that the States should be fully funded to provide adequate services to job seekers and employers. The solution proposed -- transferring the funding from Congress to the States -- does not guarantee full funding, however. Transferring the appropriation authority from one body to 53 legislative bodies does not, by itself, provide full funding and may exacerbate the problem. This is of special concern for both the Veterans' Employment and Training (VETS) program, which relies on these funds to provide special veterans' employment services, and the UI program regarding workload funding. Most State legislatures meet for only a portion of a year and six meet on a biennial schedule. This makes it difficult for States to respond quickly to changes in workload caused by an unforeseen economic downturn (or even unemployment caused by a large natural disaster) and could cause serious funding shortages at a time when they can least be afforded. In addition, this approach undermines the insurance principle of the program that funds are to be pooled into a unified account and distributed based on workload -- not on taxes paid.

The bill would also transfer the responsibility for collecting Federal Unemployment Tax Act taxes, known as FUTA taxes, from the Internal Revenue Service to the States, effective calendar

year 2000. The tax would remain a Federal tax, with the States acting as agents for the Treasury Department on a contractual basis. We do not believe that having States collect Federal revenue and having their legislatures appropriate Federal dollars with no required guidelines or standards is the best option for funding administration of these programs. The absence of guidelines and standards would seem to run counter to the Congressional emphasis on performance in the Governmental Performance and Results Act (GPRA). The Department's UI dialogue has begun to identify a variety of alternative approaches to address the administrative funding issue such as: switching the funding to the mandatory side of the budget; creating a permanent adjustment of the caps on the discretionary side of the budget to accommodate the changing needs of the Employment Security system; or if the States are to be responsible for administrative funding, combining State UI-ES administrative tax with the State benefit tax, reducing but maintaining the FUTA tax for Federal purposes. Each of these alternatives has advantages and disadvantages, and we expect further examination of these and other alternatives through the UI dialogue.

The bill calls for a wholesale restructuring of the Unemployment Trust Fund, effectively breaking the current Employment Security Administration Account into 53 State accounts. A new Federal administration account would be established for the Secretary of Labor, with funding limited to 2% of FUTA collections. This would be $70 million less than the current funding level of approximately $195 million (a 36% cut) for Federal administration of UI, ES, VETS and Bureau of Labor Statistics (BLS) oversight, and funds for State collection of labor market information. If the Secretary's obligations remain substantially the same, this option

would not allow the Department of Labor to continue to administer the programs responsibly. Furthermore, it is unclear whether the bill would maintain the current arrangements for carrying out cooperative statistical programs through the BLS since, in addition to the funding reduction, the bill appears to authorize these activities separately at the Federal and State account levels. Any such restructuring of the UI Trust Fund appropriation to the BLS could effectively terminate or radically change the National Labor Market Information program. The current trust fund arrangement supports the production of some the Nation's most important economic indicators of employment and unemployment. This includes, among others, the Current Employment Statistics survey which is designed to provide industry information on employment, hours, and earnings data used to produce the monthly Employment Situation Report for the Nation, States, and metropolitan areas.

The Extended Unemployment Compensation Account, the current source of funds for the Federal share of EB, would be eliminated by the bill, as would the Federal partnership in the program. The EB program, established to provide additional benefits during periods of economic downturn, would be funded and administered independently by each State. There would be no special funding mechanism for these benefits. Since the proposal would not reform the EB program, Congress could be faced with enacting special emergency unemployment compensation (EUC) in the event of an economic downturn. In the last recession, the Federal EUC costs were $28.5 billion -- of this amount, $12 billion were funded by FUTA and $16.5 billion were funded by general revenues. The FUTA funding would no longer be available to Congress.

Lastly, the proposal weakens State accountability by requiring States to individually determine performance and report to their Governors. The proposal still requires the Secretary of Labor to review and certify that States' laws conform and activities substantially comply with Federal requirements. Because the bill removes State administrative funding from the Federal government, there are no sanctions that can be imposed on State governments for noncompliance. Only the employers of a noncompliant State would suffer any consequences if a State failed to meet the requirements of the law. Failure of a State to meet the requirements for certification would result in a loss of credit against the Federal tax for employers in the State. This would place a State in the peculiar situation of charging employers a higher Federal tax -- 6.2% (6% after 2004) rather than 0.8% -- for a condition that the State itself caused. In the spirit of GPRA, Federal performance standards should be considered to ensure that a viable national economic security system is in place for the country while providing States flexibility to tailor the programs to their individual economies.

In summary, I agree that the administrative funding mechanism for the Employment Security program is in need of repair. However, I do not believe that transferring funding from Congress to the States achieves full funding or other necessary reforms of the program. We believe a reform bill should also address the most fundamental principle of the UI program, that is the assurance of adequate benefits for a sufficiently large number of job seekers. For instance, the recipiency rate for unemployment compensation is not addressed in the bill. In addition, a reform bill should address trust fund solvency goals and bolster the EB program -- elements that are essential to assure that the program responds adequately to economic downturns.

THE ADMINISTRATION'S APPROACH TO REFORM

With the issuance of the President's FY 1999 budget request, the Administration set in motion a reform of the Employment Security system. Due to the complexities inherent in a major reform effort, the Administration is pursuing a two-phase strategy. The first phase is comprised of a legislative, as well as an appropriations component. The funds requested in the FY 1999 budget are designed to provide full-funding for the UI program, while a long-term solution to the administrative funding problem is developed.

The Administration has also proposed legislation, H.R. 3697, introduced on a bipartisan basis by Representatives Levin, English and Rangel, that represents an important step toward addressing the issues confronting the Employment Security system. This bill would provide incentives to strengthen the UI program in the areas of recipiency, recession readiness, and administrative funding and is a "down payment" toward more comprehensive reform. The major components of H.R. 3697 are:

Recipiency -- H.R. 3697 provides incentives to States to voluntarily implement administrative systems that will make the program more accessible to low-wage workers. In each of fiscal years 1999, 2000, and 2001, $20 million will be available to reimburse costs to States to implement alternative base periods. An estimated additional 450,000 low-wage unemployed workers could be helped annually if all States adopted an alternative base period.

Recession Readiness -- The Administration's bill would enhance the Federal-State Extended Benefit program by revising program triggers to make the program more responsive during a recession. H.R. 3697 also provides an incentive -- in the form of a Reed Act distribution -- to encourage States to voluntarily improve the solvency of their unemployment trust funds accounts. Currently, 22 States have reserves below the target level recommended by the Advisory Council on Unemployment Compensation as necessary to ensure States have sufficient funds to pay benefits during periods of high unemployment. Inadequate trust fund account balances could cause States to take actions such as increasing taxes, reducing benefits, or taking out interest bearing loans in the next recession as some have been compelled to do in the past.

Administrative Funding -- The bill proposes the installation of a temporary mechanism to strengthen State funding for administration of the UI program through a special distribution to fill the funding gaps between the calculated need and the appropriated amount resulting in full funding for FY 1999-2003. This is a temporary "fix" only. A long-term solution is needed for the under-funding problem, and this will be focused on in the upcoming dialogue.

In addition, H.R. 3697 proposes to extend for ten years the Self-Employment Assistance (SEA) Program, which is due to expire December 8. SEA -- which gives greater flexibility to UI claimants by allowing them to receive unemployment compensation while becoming self-employed -- has been adopted by ten States and has proven to be a useful tool for States to assist certain unemployed workers create their own jobs by starting small businesses.

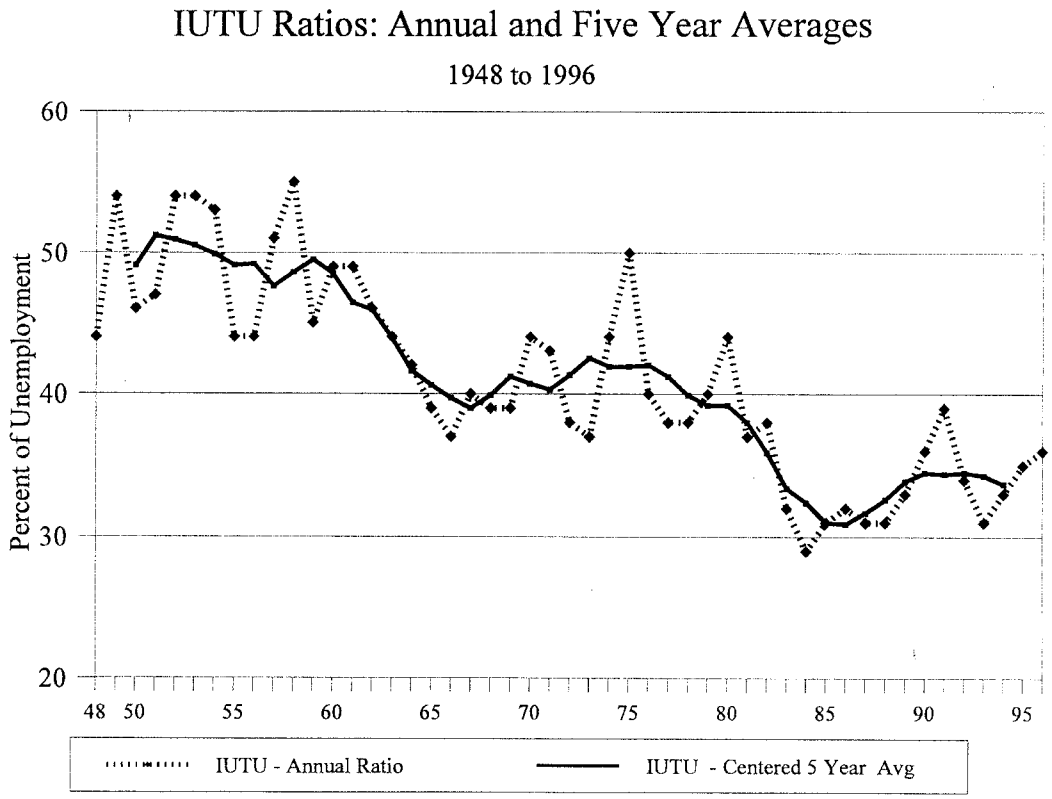
The second phase is a national dialogue which will engage all interested parties -- including Congress, workers, employers, State governments and Federal agencies -- in an effort to work through a broad range of issues. The following questions will be discussed:

- how well is the Employment Security system fostering individual economic adjustment,
- how well is it serving as a macroeconomic stabilizer,
- is the financing structure financially sound in terms of meeting core insurance principles,
- how well is the benefit financing structure working with respect to its efficiency, equity, and incentives, and
- how well does the administrative funding component work?

The UI program is an American success story -- working efficiently in good times and bad, as it helps millions of workers annually. We need to be sure we are on the right track to maintain this successful program and strengthen the nation's economic infrastructure in the coming millennium. Therefore, during the coming months, the Administration will hold public hearings, and meet with interested parties across the nation to receive input toward the resolution of these issues.

This concludes my formal remarks. I appreciate the opportunity afforded me to speak to the subcommittee and look forward to working with you, the States, and all other stakeholders who share with the Department of Labor the ultimate goal of reforming and strengthening the UI program.

CHART 1


IUTU Ratios: Annual and Five Year Averages
1948 to 1996
Percent of Unemployment
60
50
40
30
20
48
50
55
60
65
70
75
80
85
90
95
IUTU - Annual Ratio
IUTU - Centered 5 Year Avg

Ch. 2

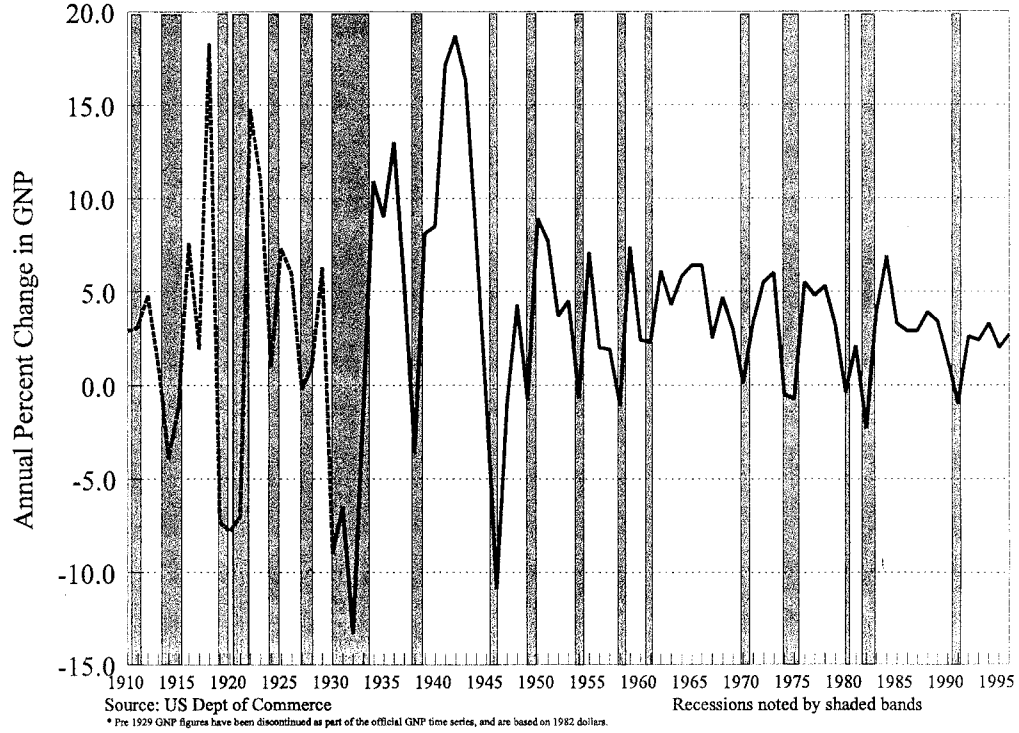
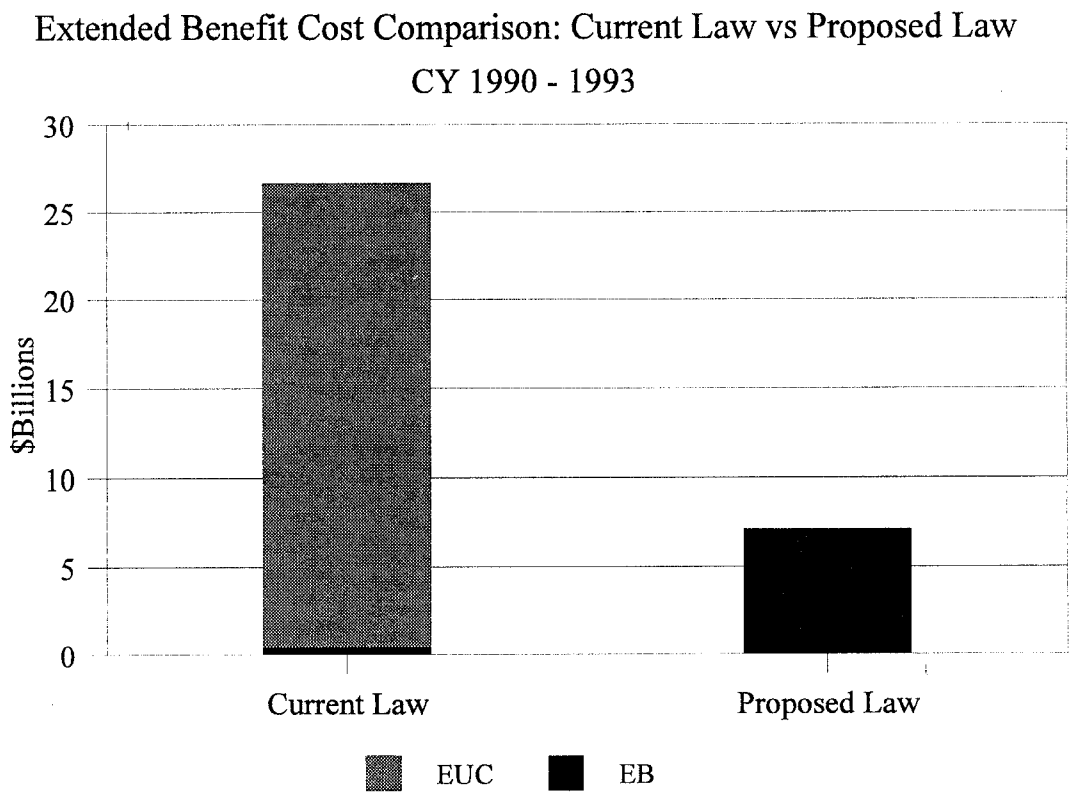

Change in Real Gross National Product
CY1910*-1996, based on 1992 dollars
Annual Percent Change in GNP
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
1910 1915 1920 1925 1930 1935 1940 1945 1950 1955 1960 1965 1970 1975 1980 1985 1990 1995
Source: US Dept of Commerce
Recessions noted by shaded bands
* Pre 1929 GNP figures have been discontinued as part of the official GNP time series, and are based on 1982 dollars.

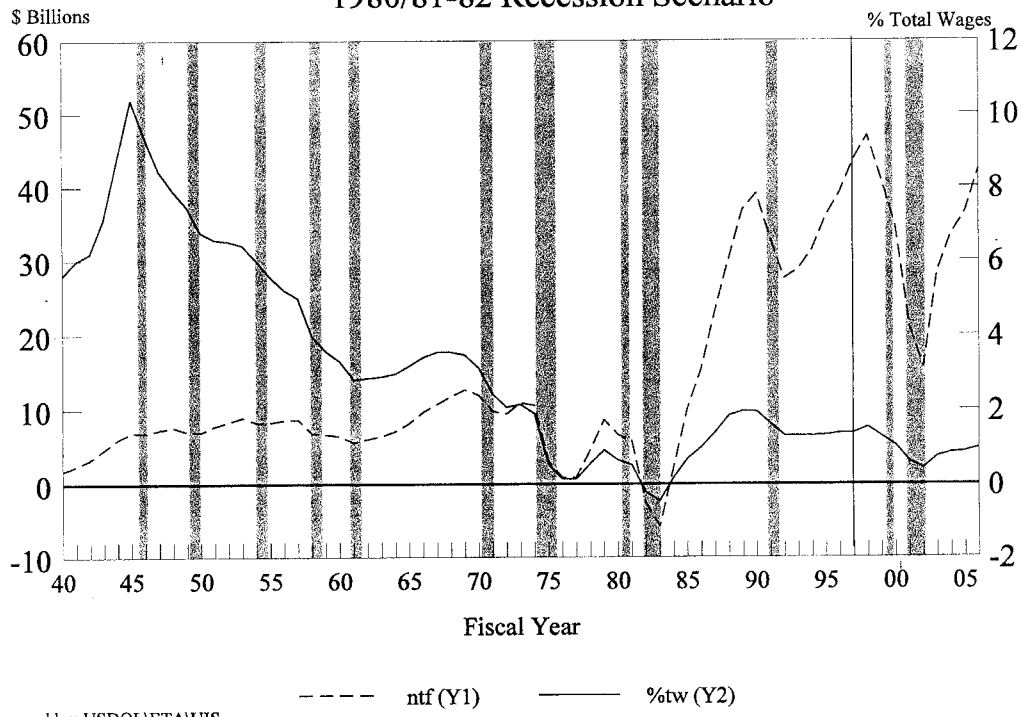
ChART 3


Extended Benefit Cost Comparison: Current Law vs Proposed Law
CY 1990 - 1993
$Billions
30
25
20
15
10
5
0
Current Law
Proposed Law
EUC
EB

.T 4

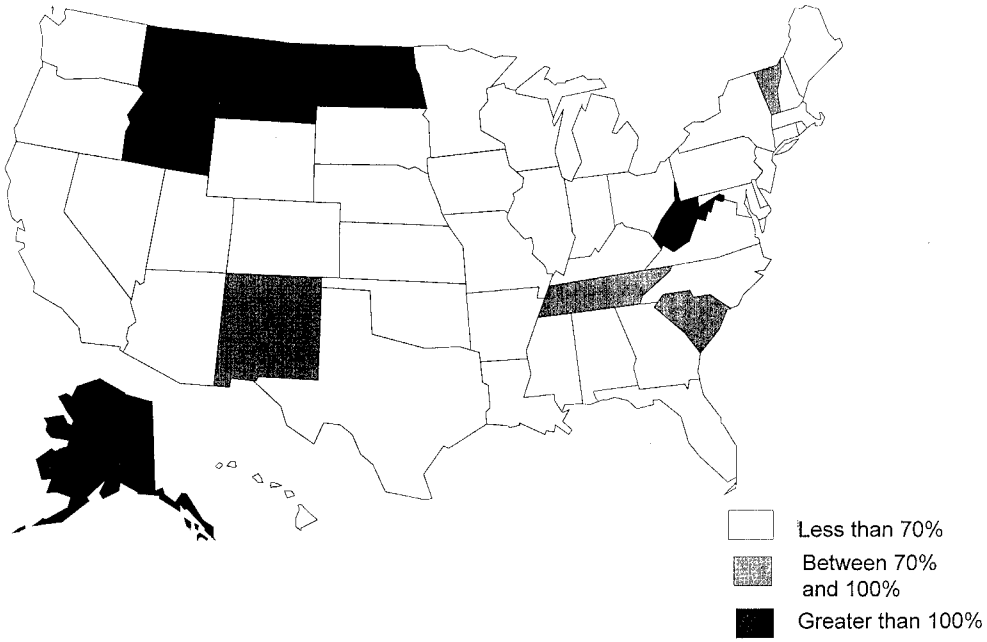
Projected Status of Net State Trust Funds

1980/81-82 Recession Scenario



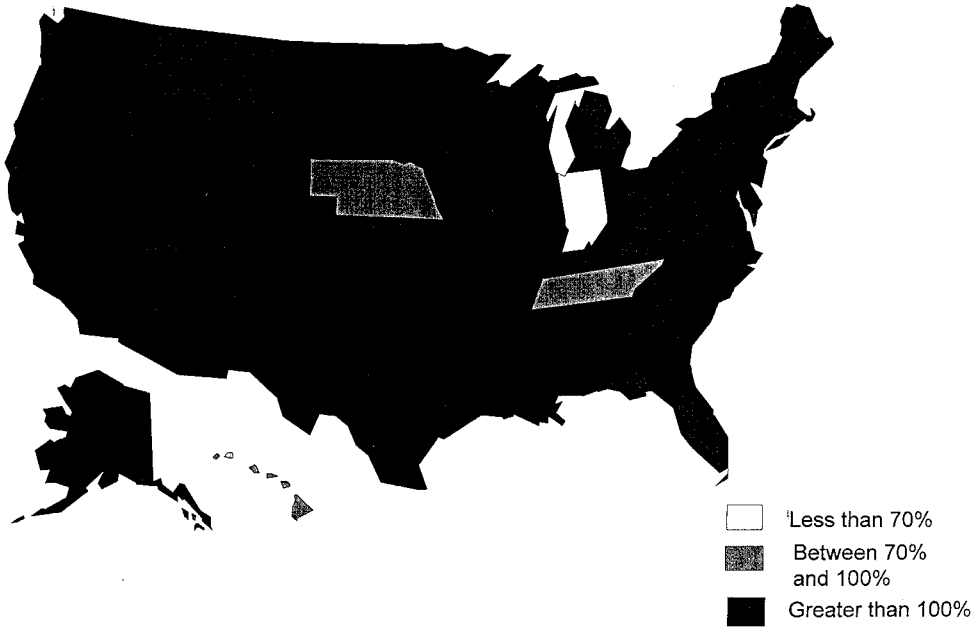
Prepared by: USDOL\ETA\UIS

FUTA Collections vs. Amounts Returned
FY 1989



EXCLUDES GENERAL REVENUE

FUTA Collections vs. Amounts Returned
FY 1992



EXCLUDES GENERAL REVENUE

Chairman SHAW. Ms. Kilbane, we've seen all the charts and we've seen the maps and we know the amounts of money and what happens in a recession and what doesn't, and I think through both of those years, I've been serving in the Congress, but the question remains that some $6 billion has been paid in and about $3.5 billion have paid out. Where's the money? Where does it go?

Ms. KILBANE. Well, first of all, we agree that we do need to get more administrative funding back to the States. Currently, as you mentioned——

Chairman SHAW. Don't tell me, don't answer the question as to where we're going. If you could tell us what happened? I'm just asking for the history? What happened to the money? The only way we're going to keep history from repeating itself is to find out what happened.

Ms. KILBANE. The money is retained in the Federal accounts. The Federal accounts are three. They're for three purposes: administration of the program, Federal loans, and for extended benefits. Now, we don't need the Federal loans and extended benefits when times are good, but we do need to build up those accounts. Currently, there's $18 billion balance in the Federal loan accounts, which is where these balances are going and so they've been building up over the last few years.

Chairman SHAW. Well, do you think that it's necessary to build them up to that extent?

Ms. KILBANE. Well, as I mentioned——

Chairman SHAW. I mean, at some point, don't you think we ought to maybe get rid of that temporary tax, .02 percent?

Ms. KILBANE. I think to the extent that we don't need the taxes that we shouldn't collect them. But I also think that we want to run an insurance program——

Chairman SHAW. Can I take that as the administration's position?

Ms. KILBANE. I'm sorry?

Chairman SHAW. Can I take that as the administration's position, that as long as you don't need it, you shouldn't collect it?

Ms. KILBANE. Right. And the administration's position is that we should have an actuarially sound trust fund, including the Federal accounts. In the last recession——

Chairman SHAW. The $18 billion——

Ms. KILBANE [continuing]. We went through $28.5 billion.

Chairman SHAW [continuing]. Is that going in to make up part of the surplus that the administration and the Congress are bragging about so much? What's in that account, does that go in the unified budget?

Ms. KILBANE. It goes into the unified budget, that's right.

Chairman SHAW. So there's about $18 billion, another $18 billion, we're finding out that's in the trust fund that we really shouldn't be calling part of the surplus. So, as I take it, the way you've answered my question, in that, unless there's some actuarial reason to keep that .02 tax on there, that we ought to get rid of it?

Ms. KILBANE. I think that's correct, but I think the administration's position is that at this point, actuarially, we need to make sure that those accounts are built up to cover a downturn.

Chairman SHAW. What amount is necessary?

Ms. KILBANE. Well, the administration has put forward an extension of the two-tenths through the year 2007, but we are also expecting that the Reed Act would——

Chairman SHAW. Wait a minute, the administration thinks that that two-tenths should stay in until the year 2007?

Ms. KILBANE. That's the current law.

Chairman SHAW. I mean, do you think that's what it ought to be?

Ms. KILBANE. We are anticipating in the year 2003 that the Reed Act distributions would reduce those Federal accounts by spilling over excess administrative funds to the States, and we think that that's the proper way of taking care of that.

Chairman SHAW. Does that $18 billion that's in the surplus fund account for most of the imbalance of what's paid in compared to what comes out? I mean this is, I don't know of any program that crazier than this as far as the imbalance of the monies. This isn't just a question of socking the employer, this is part of the employees' compensation, so I think we need to put this on the right plane. This is part of the compensation paid to labor today. So this is not a big business issue any more than it is a big labor issue, and it's one that I think jointly we should address and do something about. And if the monies are not necessary and if we've got these huge surplus funds, let's give the guy a break.

Ms. KILBANE. Right, and, Mr. Chairman, I guess I would say that the administration does not agree that the funds are not necessary. We think that we need to, just like a private insurance company——

Chairman SHAW. I'm just talking about now just the .02 percent.

Ms. KILBANE. Well, the .02 percent is part of the overall FUTA funds that goes to build the Federal accounts, and as those two charts (charts 5 and 6) show that when——

Chairman SHAW. Well, let's cut it short——

Ms. KILBANE [continuing]. You hit an economic downturn, you need more money.

Chairman SHAW [continuing]. Where should the surplus fund be? When are we going to stop, at $25 billion, $30 billion, what do you think is reasonable?

Ms. KILBANE. Well, the analysis——

Chairman SHAW. It's $18 billion now.

Ms. KILBANE. The analysis that we did last year when the two-tenths was continued showed that if we hit an economic downturn like the 1980's, we would end up—States would end up borrowing somewhere in the neighborhood of $25 billion, and we would also be paying extended benefits. And so we didn't think that $18 billion, at that time, looked like too much money, nor do we now. I don't have a magic figure off the top of my head. We look at the percentages of the caps as in relation to our past experience with recessions.

Chairman SHAW. Well, do you think you could supply this committee with what would be a reasonable figure, according to the administration, to be put in this trust fund?

Ms. KILBANE. We'll give you whatever we can give you——

[The following was subsequently received:]

A simulation shows that approximately $25 billion is needed in the Federal accounts right now in order to remain solvent in the event of a 1980s-type recession in the near future. The necessary balance will grow in future years as growth in the labor force and in wage levels causes potential recessionary outlays to increase. This estimate assumes that the changes to the Extended Benefit program proposed in H.R. 3697 will be implemented. It should be noted that the extended benefit account was also used to fund the Emergency Unemployment Compensation program in the last recession.

Chairman SHAW. Now, this trust fund is this—this trust fund really is a fiction though isn't it? I mean, is there actually money in it? It's just an account isn't it?

Ms. KILBANE. Well, my understanding is that all trust funds are part of the unified Federal budget.

Chairman SHAW. Yes, they're all fraudulent. There's no money out there is there? [Laughter.]

Ms. KILBANE. I didn't create the trust fund. [Laughter.]

Chairman SHAW. We couldn't go write a check on the trust fund so what we're really looking at, even though we can put that into the trust fund and say, "Hey, it's out there for a rainy day," there's really no money. And what will be today will come out of the deficit of tomorrow, if it's needed to be drawn down, isn't that correct, because it's all in the unified budget?

Ms. KILBANE. My understanding is that that's correct but it is still part of the trust fund and the balance is like other trust funds, my understanding is, are tracked separately.

Chairman SHAW. Well, I can tell you that if lawyers would all treat their trust funds like the United States Government did, we wouldn't have any more lawyers because they'd all be in jail. And I think that's something that we ought to really be thinking about. We're setting up these fictions and that's—we need to take care—and I'm all for pay-as-you-go, but this is no pay-as-you-go, this is a fiction.

Ms. KILBANE. Well, I think that——

Chairman SHAW. It's stealth. It's not out there. It's just something we talk about. It's a feel good type thing but what it is is we're just taxing the hell out of the employer and the employee in order to build up something that will make our surplus look good, and it has nothing to do with the trust fund because it's not a trust fund.

Ms. KILBANE. Well, and I think that the administration, from our perspective, in launching a broad dialogue on reforming the unemployment insurance program, which I have also brought copies of our complete paper that was released today, would hope that we could get into all areas of how do we fix this program? And, certainly, to the extent that we would get into a broader discussion about trust funds, or how to fund it, or where to fund it, where to shift the funding to, we would see that as being a better way of approaching this issue.

Chairman SHAW. Okay. Mr. Levin.

Mr. LEVIN. Well, I think that last exchange has been useful and we need to trace what's happening with the Federal monies. They're part of the unified budget, all the trust funds are. I don't think that makes them fraudulent. We have a highway trust fund, an aviation trust fund, and there is some sense of obligation as to the use of those monies. And, in a sense, it's a fiction, it isn't a

trust fund in a strictly legal sense. It is, I think, however, something that has some meaning to it. And I've been one who has suggested we don't spend the surplus because it essentially exists because of the inflow from Social Security compared to the outflow. I don't think that means that it's a fraudulent system.

But, most importantly, I don't see why that means we should simply throw all of this into the States and have a—if that's true, let's have a 50 State unemployment comp system. The trouble with that is what do you do when there's a recession? And there's a recession in some States, not in others? We talk about the flow-in being greater than the outflow and we have this surplus, and this is a complicated—I once sat through a long explication of the three trust funds, it's very complicated. And, perhaps, we can simplify it. But it turned out in the 1980's, we did not have enough money to pay for extended benefits and we, as a result, had to dip into the general fund, isn't that true?

Ms. KILBANE. Yes, Mr. Levin, that was in the 1970's recession and that's the reason that the two tenths, temporary tax was put on.

Mr. LEVIN. Oh, so in the 1980's, when we had the recession, and I remember the fights we had relative to Pennsylvania and other States that were in difficult positions and had trouble using the laws, we amended it, and the triggers did not really help, we had tens of thousands of unemployed workers who had exhausted their benefits and simply, through no fault of their own, could not find a job. And I think it would be interesting for us to get a break-out of which States are in trouble in terms of administrative funds and which States are in trouble in terms of solvency. I think it also would be interesting to compare the benefits that are paid State by State, and to look at the recipiency rates State by State. They vary substantially, don't they?

Ms. KILBANE. Yes, there's a wide-range, like between 20 percent and 50 percent on recipiency, for example.

[The following was subsequently received:]

State Level Program Indicators - CY 1997

Replacement Rates	
Rhode Island	57.3
New Jersey	54.4
Pennsylvania	53.5
Kansas	53.5
Arkansas	52.8
Texas	52.3
Minnesota	51.9
Hawaii	51.6
North Carolina	51.6
Maine	51.5
Iowa	50.9
Wisconsin	50.2
Indiana	50.1
Idaho	49.7
Michigan	49.6
Wyoming	49.5
Colorado	49.4
Oklahoma	49.2
Florida	49.0
Washington	48.9
Utah	48.7
Delaware	48.2
Maryland	47.6
South Carolina	47.5
Nevada	47.5
Mississippi	47.2
United States	**47.0**
Dist. of Columbia	47.0
Vermont	47.0
Nebraska	46.6
Virginia	46.5
North Dakota	46.5
Oregon	46.5
South Dakota	46.4
New Mexico	46.0
Arizona	45.5
Massachusetts	45.2
Missouri	44.7
Connecticut	44.7
Puerto Rico	44.5
Tennessee	44.4
Alabama	44.0
Kentucky	43.9
Georgia	43.5
New York	42.9
Montana	42.8
West Virginia	42.1
Ohio	41.6
Illinois	40.9
New Hampshire	38.5
California	38.4
Louisiana	37.0
Alaska	32.2
Virgin Islands	

Average High Cost Multiples	
Virgin Islands	2.78
New Mexico	2.58
Vermont	2.43
New Hampshire	2.30
Georgia	2.22
Delaware	2.17
Florida	1.89
Mississippi	1.88
Oklahoma	1.87
Utah	1.84
Arizona	1.70
Wyoming	1.67
Puerto Rico	1.65
Virginia	1.61
Indiana	1.58
Kansas	1.41
Nebraska	1.39
South Carolina	1.37
Iowa	1.33
Louisiana	1.30
North Carolina	1.27
Idaho	1.26
Oregon	1.24
Montana	1.24
Hawaii	1.21
Wisconsin	1.16
New Jersey	1.13
Colorado	1.11
Nevada	1.06
Tennessee	1.04
Washington	1.02
South Dakota	1.01
Alaska	0.98
Maryland	0.97
United States	**0.94**
Massachusetts	0.94
Alabama	0.81
Kentucky	0.76
Connecticut	0.75
Dist. of Columbia	0.71
California	0.70
Maine	0.70
Michigan	0.65
Pennsylvania	0.65
Ohio	0.63
Arkansas	0.63
Rhode Island	0.61
Minnesota	0.59
Missouri	0.58
Illinois	0.50
West Virginia	0.43
North Dakota	0.39
Texas	0.33
New York	0.31

Recipiency Rates	
Rhode Island	59.3
Washington	52.8
Vermont	51.8
Alaska	49.9
Wisconsin	49.4
Massachusetts	49.3
Nevada	48.6
North Dakota	48.4
Pennsylvania	48.1
New Jersey	45.0
Arkansas	44.5
Michigan	43.3
Dist. of Columbia	42.9
Oregon	41.6
Illinois	40.6
Delaware	40.4
Minnesota	40.1
California	39.1
Connecticut	39.0
Idaho	38.4
Iowa	37.4
Montana	37.1
Hawaii	36.7
Maine	36.5
United States	35.1
North Carolina	35.0
Missouri	33.9
New York	33.9
Puerto Rico	32.1
West Virginia	31.0
Nebraska	30.6
Tennessee	30.2
South Carolina	29.5
Ohio	29.3
Indiana	29.2
Kansas	28.0
Mississippi	28.0
Alabama	27.8
Colorado	27.6
Utah	27.6
Wyoming	27.4
Maryland	27.3
Kentucky	26.9
Florida	24.0
New Mexico	23.9
Texas	22.3
Georgia	21.6
Arizona	21.4
South Dakota	21.1
New Hampshire	20.3
Louisiana	19.5
Oklahoma	19.4
Virginia	19.2
Virgin Islands	n/a

States who have reduced UI taxes at some point between 1992 and 1997 are shaded.

** RECIPIENCY RATES UPDATED TO REFLECT ANNUAL BLS BENCHMARK REVISIONS

03/27/98

Mr. LEVIN. My guess is that some of the States that are pressing for devolution are States that have very low recipiency rates and what it means when you have low recipiency rates is that some of those workers go to other States. So I hope we can take an objective look at what's going on. This is a very mixed system. It's a partnership but a very mixed system.

But what would happen if we just said to every State, "Do your own unemployment comp?" Give them all the administrative, just tax your own employers.

Ms. KILBANE. I think that our position is that we should take a look at this as a Federal/State system, that there are national issues, that we do have a global economy, that recessions happen in regional pockets, not just State by State, and that we should agree on what we want to achieve as a Federal/State system and make sure that we've got at least some standards or goals laid out and then proceed with making sure that we're funding it adequately.

Mr. LEVIN. Why have any standards? I mean, right now it's a very mixed, I think you could argue, even a mixed-up system. There are standards but there are very different levels of eligibility, of benefits, why not just let every State do what it wants?

Ms. KILBANE. Well, I think that our concern would be that we have had a very successful, in the past, economic safety net for this country, which has involved a Federal/State partnership. And if you look at, for example, the Macroeconomics Stabilization Chart (chart 2) and the contributions that we've made to smooth some of the recessions that we've had, that it's important to keep that Federal/State partnership in place.

Mr. LEVIN. I think the answer is that if every State did what they wanted, it would mean that some of them would simply shuffle the responsibilities to other States and people would move during recessions, or they would try to move, and then we would end up with national economic emergencies where the Federal Government would have to bail out States that did not meet their responsibilities, and we would have an unemployment system somewhat like we have a hurricane system. And the Federal Government would end up as the payer of last resort, with States coming here and pleading for help. And the unemployed would be left, talking about a hurricane, high and dry.

Thank you.

Chairman SHAW. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. Before I ask a couple of questions, I want to join Mr. Jefferson in welcoming the State of Louisiana's Secretary of Labor, Gary Forrester, who's not testifying but he's here observing today. Welcome, Secretary Forrester.

Let me just try to clear up this trust fund concept. I think "actuarially sound" is maybe a good phrase but let's examine what that means. You say there's about $18 billion in the trust fund. Where is that $18 billion? Where is it kept?

Ms. KILBANE. Well, it's part of the unified budget, the $18 billion in the Federal accounts is kept as part of that account, as part of the unified budget.

Mr. MCCRERY. Is there any cash in the bank so to speak for that trust fund?

Ms. KILBANE. Again, my understanding of how Congress has set up a Federal unified budget is that all trust funds are part of it, and that for trust funds, you account for the funding separately so that you know what's there for those purposes.

Mr. MCCRERY. Sure, it's accounted for separately but the fact is there's no cash in the bank in the trust fund. It's all I–O–U's. It's Federal securities. And there—it's the safest I–O–U in the world but it's an I–O–U, it's paper. So if we were to have a recession and there would be a call on this supposed trust fund, there wouldn't be any money there would there? You'd have to get the money from current revenues, and you'd use those current revenues maybe to redeem the I–O–U's. Big deal. You still have got to find the cash. You've got to find it from current revenues. So what's the difference if we've got a paper trust fund or not? It doesn't make any difference as a practical matter.

So, I think this is all a fiction we've been talking about this trust fund. And the chairman is right. If we're collecting more money than we need to finance the system, let's don't collect it knowing that someday we're going to have a recession, we're going to have to make accommodations for that expenditure, as we have in the past, probably with deficit-spending, and be done with it. But let's not have this fiction and create this need, this supposed need for more taxes. And that's all we're doing.

And so I think the chairman's legislation is perfectly correct in saying let's give the .02 percent surtax back and then the next time we have a recession and we have to spend a bunch of money, maybe we can create another surtax to repay ourselves but let's don't do it when we don't have to.

Have Federal unemployment taxes ever gone down to your knowledge?

Ms. KILBANE. No, not to my knowledge.

Mr. MCCRERY. Have they gone up?

Ms. KILBANE. Well, by two-tenths of a percent, that's correct.

Mr. MCCRERY. That's all since the first——

Ms. KILBANE. Yes.

Mr. MCCRERY. Just two-tenths of a percent? Under the chairman's bill, employers under——

Ms. KILBANE. Can I clarify that?

Mr. MCCRERY. Yes, please?

Ms. KILBANE. The tax base has gone up, has increased, the Federal tax base over the years.

Mr. MCCRERY. Yes, and taxes have never been cut nor has the base been reduced.

Ms. KILBANE. The base is currently $7,000.

Mr. MCCRERY. Right. And it's gone up from the initial base, it's gone up.

Ms. KILBANE. From the initial base, that's correct.

Mr. MCCRERY. Right. Under the chairman's bill, employers would file four unemployment tax payments per year, one consolidated Federal/State payment each quarter. Now the current system requires eight filings. The administration's Fiscal Year 1999 budget proposal would require 24 tax filings. Is that still the administration's position?

Ms. KILBANE. That is in the administration's request, that's correct.

Mr. MCCRERY. If you were an employer, which would you prefer?

Ms. KILBANE. If I were an employer, I would probably prefer the former.

Mr. MCCRERY. Then I suggest we try to find a way to make it easier, not harder, on the employer and just use common sense. If we can collect the same amount of money through an easier system, with a consolidated filing, let's work together to try to find a way to do that.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Jefferson.

Mr. JEFFERSON. Thank you, Mr. Chairman. I would also like to recognize our Secretary of Labor, who I had a chance to meet with this evening—this afternoon, as I'm sure Mr. McCrery did, we used to serve together in the State legislature. Good to see you here, sir.

This is a rather complicated problem we have on our hands and it's not necessarily made more simple by the solutions that are offered today.

I'm concerned about the issues you raised about the lack of guarantees, particularly with respect to the lack of guarantees with respect to what States will do with the money if they were to receive it. Would they establish trust funds of their own, or would they use the money for some other related purpose, for State administration, for something else, I don't know. And isn't there reason to require trust funds? After all, we all could hear that there isn't one, but are we then going to put ourselves in the same position on the State level to say that there may or may not be one.

That's a concern which you raise. Do you see how that concern can be addressed in the context of the bill Mr. Shaw offers, or is it something that we can't remedy in the context of his legislation?

Ms. KILBANE. Well, I would think that what the administration was hoping to do by putting forward the dialogue paper was to discuss all of these—the proposals included in H.R. 3684, as well as other ways to look at it, including maybe putting performance standards in place a la GPRA or other ways of guaranteeing that we maintain a Federal/State system, even if we restructure it and reform it, and completely change the way we've done business. I mean, maybe we should take our trust funds out of the Federal Unified Budget to resolve some of the other issues that have been raised.

Mr. JEFFERSON. You speak of a lack of a guarantee with respect to the States responding quickly, either in the case of an economic downturn or in the case of, I think you described it as, an emergency. Is this because based on our experience in doing this sort of thing or they might have different setups State by State?

I guess my question is, is this something that can be fixed, and if it is, if it can be, how can it be fixed in the context of this legislation? Or is it something that you have to worry that each State is going to have to develop some capacity to do?

Ms. KILBANE. We believe that the legislation that we have proposed through Representatives Levin, English, and Rangel would put forward a target for solvency, for example; that States would have to work toward having at least one year of benefit payments

at the average of a high three bad years, and that that would help in terms of having a goal, where we could have States work toward that.

The other is, of course, without any goals the results could be underfunding the program, which then costs more money during a recession. What we know is that, if we have to borrow money, we raise the taxes on employers during a recession.

Mr. JEFFERSON. Our Labor Secretary talked about the need for—at least with me he did—for more administrative money on the States' part out of these funds. Does Mr. Levin's legislation address this issue? And does it address it right now?

One matter that he was concerned about was, whatever you do, he wanted it to be done fairly quickly. The idea of having it done in 2003, or whatever, seemed an idea which is too distant for him to get his arms around, because he thought basically, who knows what by 2003—that's too far out to make much of a plan for. Even for his own career plans it's too far out.

So the idea is, if we're going to do something, why does it take us that long to do it, and does Mr. Levin's bill address this issue in a more timely way?

Ms. KILBANE. Yes. H.R. 3697 would make sufficient funds available for unemployment insurance this year, 1999, as well as for the next four years. This is a temporary funding fix, until we can work on a more permanent one, which is what we would like to see through the dialogue and through the coalition proposal.

Mr. JEFFERSON. Could we move toward a solution not so much that would take away the Federal/State partnership, like perhaps Mr. Shaw's appears to do now, but that would address some of the concerns that he has in great detail and at the same time keep this partnership going, and use Mr. Levin's approach as a temporary one, a kind of a bridge one, until we can make more changes that will be in place over a longer period of time?

Ms. KILBANE. Yes, exactly. We believe that these bills could—that they're not competing bills; that one takes place in the next five years and one is a more permanent reform that becomes effective subsequent to the five-year window.

Mr. JEFFERSON. Thank you, Mr. Chairman.

Chairman SHAW. Thank you. I would just like to comment with regard to the year 2003 the problems are budgetary because we're using this stealth surplus which goes into the stealth trust fund as a budget problem. It creates a budget problem because of the Unified Budget. And that's the problem, and that's the reason why it's got to—we've got to work with those type of years.

Mr. JEFFERSON. This $20 million, Sandy, there's a figure in your—I missed it here—that you appropriated this year for distribution to the States. How much money? It can't be $20 million. What's the number, Sandy, we're dealing with?

Mr. LEVIN. There's $106 million for administrative funds and about $20 million for low-income workers.

Mr. JEFFERSON. Oh, that's what I'm thinking about.

Mr. LEVIN. If I might use your time, Mr. English is next, and then I just want to ask a quick question, Mr. Shaw.

Chairman SHAW. Mr. English?

Mr. ENGLISH. I'm happy to yield to the gentleman from Michigan.

Mr. LEVIN. No, go ahead. I just wanted on the FUTA tax to just be clear, so I'll ask it, if I might. What bill extended the two-tenths of 1 percent to the year 2007, do you know?

Ms. KILBANE. It was the Balanced——

Mr. LEVIN. It was the Balanced Budget Act?

Ms. KILBANE [continuing]. The Balanced Budget Act last year.

Mr. LEVIN. It was the Balanced Budget Act——

Ms. KILBANE. That's right.

Mr. LEVIN [continuing]. That I think most people on this panel voted for.

And the bill of Mr. Shaw would extend it until when?

Ms. KILBANE. Until the year 2004.

Chairman SHAW. Sandy, I would like to point out that the President made that as a condition for his signing the bill. That was the reason it's in there.

Mr. ENGLISH. I'll reclaim my time, if that's——

Mr. LEVIN. I think you'd better. [Laughter.]

That's why I hesitated to raise it during your time. I hope the Chair will give you a full 5 minutes. [Laughter.]

Mr. ENGLISH. No, no, I'll be fine. Mr. Chairman, I'll keep my questions relatively brief, but I want to ask a couple of specific questions, Ms. Kilbane.

One, could you elaborate on your concerns of the effect that devolution or the chairman's approach to devolution might have on the vets' program?

Ms. KILBANE. Well—our vets' organization believes that the way the bill is written would put the responsibility for funding this program at the State level, and they have concerns that States could independently make decisions to reduce services to veterans by reducing funding for veterans.

Mr. ENGLISH. I think that's a legitimate concern, and it's one that I don't think is necessarily fatal to a significant overhaul of unemployment compensation, but certainly it's an issue that I think would have to be addressed as part of an overhaul of unemployment compensation.

I wonder, under the bill that the chairman has proposed, what options would the Federal Government have to impose sanctions for noncompliance on States?

Ms. KILBANE. The Federal Government currently has two ways of imposing sanctions for noncompliance. The first one is that employers in States that are noncompliant lose their offset credit reduction. So their taxes would go from .8 percent to 6.2 percent.

The other method we currently have is we can withhold administrative grants from States under Title III Social Security Act. We would lose that under this bill because we would no longer be in the grant-making business, but we would still be in the business of being able to basically enforce it on employers through loss of their offset credit.

Mr. ENGLISH. In your view, from your recent experience, is this a significant lose of leverage or not?

Ms. KILBANE. We believe that both are important, because one goes after certainly the employers, which is known as the atomic

bomb around our office, because it's so huge. But the second is the threat of loss of administrative grants, which is sort of the usual way that Federal agencies are able to manage and oversee Federal grants.

Mr. ENGLISH. Well, I guess I'd like to close with a couple of observations. One, I think there is some agreement on the panel that the level of administrative funding for the States has not been adequate, and I do believe that needs to be addressed.

Second of all—and I hope the administration will appreciate this perspective—I used to work as a legislative aide specifically dealing with some of these issues for the Pennsylvania State Senate, and I think the way the law is written right now does provide for a level of micromanagement at the Federal level which is not entirely appropriate. But it seems to me that the micromanagement could be significantly reduced without necessarily moving toward a radical restructuring, as envisioned in the chairman's bill.

My concern is I think there clearly is a Federal role in unemployment compensation, and I would feel probably a greater one than the chairman's bill actually allows. But I wonder if this micromanagement couldn't be addressed and still retain essentially a Federal system. Do you want to comment on that?

Ms. KILBANE. Well, I think, clearly, the dialogue that we have launched on how to reform unemployment insurance and the employment service programs is open to not only things like recipiency rate and economic stabilization, but what is the Federal/State role, and how can that be done better, looking into the 21st century? So we would certainly be open to all kinds of comments about how to improve that.

Mr. ENGLISH. Thank you, and I'll yield back the balance of my time, Mr. Chairman.

Chairman SHAW. Thank you.

Ms. KILBANE. Thank you, Mr. Chairman.

Chairman SHAW. Our next witness is Robert R. Cupp, president pro tempore and cochairman of the Senate Finance Committee, and past chairman of the Unemployment Insurance Authorizing Committee, the Ohio State Senate. Joseph Weisenburger is the Deputy Commissioner of the New Hampshire Department of Employment Security; Douglas Jamerson, Secretary of the Florida Department of Labor and Employment Security, and Dr. Janet Norwood, who is a senior fellow, the Urban Institute.

I welcome all of you. This last witness took more time than I had anticipated. I am going to try to enforce the five-minute rule. We do have all of your statements, and it will be made a part of the complete record. I would request that you might try to summarize.

Mr. Cupp.

STATEMENT OF ROBERT R. CUPP, PRESIDENT PRO TEMPORE, COCHAIRMAN, SENATE FINANCE COMMITTEE, OHIO STATE SENATE

Mr. CUPP. Thank you, Mr. Chairman and members of the committee. My name is Bob Cupp, and I am the president pro tem of the Ohio Senate. And, Mr. Chairman, for eight years before being selected for that position, I chaired the Ohio' Senate's Commerce and Labor Committee, which had jurisdiction over unemployment

and employment compensation issues. I'm also a member of the Senate Finance Committee, which handles budget issues and appropriations.

Mr. Chairman, in our senate——

Chairman SHAW. I was just told that you're the Bill Archer of Ohio. [Laughter.]

Mr. CUPP. Thank you, Mr. Chairman. Thank you, I think. [Laughter.]

I have sat on your side of the bench in the Ohio Senate, so I appreciate your request for brevity, and I appreciate the opportunity to testify in support of H.R. 3684, but I just want to make two issues.

One, I want to explain why as a State legislator who has dealt with unemployment compensation issues I think this bill is important for States and for providing a better system of employment security, and to assure you that States like Ohio are fully capable of the new responsibilities the bill would put on them and exercising the flexibility that is granted by the bill.

The funds that Ohio gets from the FUTA trust fund are seriously inadequate to meet the costs of properly administering the employment services program. It has resulted in the closing of 22 local employment offices just in the last four years alone. Ohio once had 120 offices; we're now down to 57. In my senate district, which includes seven counties, there are only three employment offices left, and I represent a geographical area that is big as the States of Rhode Island and Delaware combined.

The Bureau of Employment Services has also cut staff and are operating at historically low levels. If we were to have a recession, we would not have the capacity to respond.

More offices would have been closed except the State has put in general tax revenue—$50 million in the last four years alone, and that pays for services that the FUTA funds are paid by employers to support. So Ohioans are double-taxed in this regard. Employers pay enough in FUTA taxes to fund the employment security operations, but still money that's paid in by all Ohio taxpayers must be used to support the very thing that employers are paying the FUTA taxes for.

For our new State budget year, which begins July 1st of this year, funding from Ohio's general revenue fund to support district offices and other support services for our system will go up 85 percent. The money could be used for schools; it could be used for children's health needs; it could be used for economic development purposes, but it's basically supplementing something that employers are already paying for. Without this additional State money, we would have to close an additional 15 employment offices.

Employers pay the FUTA tax, which is a dedicated tax to pay for administering the system, for the Public Employment Service, for veterans' reemployment assistance, and for labor market information. In fact, Ohio employers in 1995 paid $259 million but got back only $102 million, less than 39 cents on the dollar. And I understand the newly released 1996 figures have made the situation even worse. And it's not unique to Ohio alone.

The general assembly has passed Senate Concurrent Resolution 10 without dissent, which asks Congress to return adequate dollars

to the State, to give employers a fair return on the taxes they pay, and I'm pleased to say that five members of Ohio's congressional delegations are cosponsoring your bill, Mr. Chairman.

H.R. 3684 would correct the flawed system. It would give States adequate money to operate the system that they do. It would give employers a fair return. It assures unemployed workers adequate levels of service in the payment of benefits and in assistance in finding new jobs. And it will allow States the flexibility they need to meet current needs, to be able to shift some money here or there as is necessary to have the best-run system, and also the predictability to meet the long-term needs.

Mr. Chairman, members of the committee, I want to assure you that State legislatures are fully capable of handling this new responsibility. We already collect the State portion of the unemployment compensation tax. That amount that we already collect is two to three times greater than the FUTA tax we would be collecting under your bill, Mr. Chairman. For 60 years, States have set unemployment benefit and tax rates, and States already appropriate the special administrative funds from employer penalty and interest charges.

The legislature in Ohio and in other States is experienced in deciding how much to allocate for employment services around the State. We are experienced in meeting FUTA conformity requirements in our unemployment laws. We're experienced in utilizing dedicated funds only for dedicated purposes—improper budgeting and balancing budgets year after year, and setting aside funds for future needs.

The legislatures and the governors of this country are already doing the things similar to what they would be doing if your bill passes, Mr. Chairman. We're doing it capably, and thank you for sponsoring the bill, because if it is passed, it will allow us to do an even better job of administering the system and serving the unemployed. Thank you.

[The prepared statement of Mr. Cupp follows:]

Testimony of Robert R. Cupp, President Pro Tempore, Ohio Senate
In support of HR 3684
To the Subcommittee on Human Resources, Committee on Ways & Means
The Honorable E. Clay Shaw, Jr., Chairman
US House of Representatives, Washington, D.C., June 23, 1998

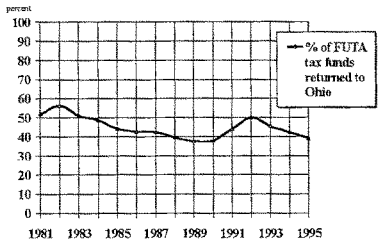
Thank you, Mr. Chairman and members of the Committee, for the opportunity to testify before you on HR 3684. I am Robert R. Cupp, President Pro Tempore of the Ohio State Senate. Prior to being selected by our Senate as the President Pro Tempore, I chaired the Commerce & Labor Committee, which had jurisdiction over unemployment and employment services issues, for seven years. I am still a member of that Committee. I also serve on the Ohio Senate Finance Committee, which makes appropriations for our state's "employment security agency," the Ohio Bureau of Employment Services.

HR 3684 is tremendously important to Ohio, as it is to other states, as well. Already four of Ohio's Members of Congress are cosponsors, demonstrating the importance our state attaches to this proposal. Today, I want to briefly describe why, from the perspective of a ***state*** legislator, this bill is important, and assure you that state legislatures are fully capable of assuming the new duties and flexibility provided by the bill.

We recognize the importance of FUTA-funded services to help workers find their next job and to help employers find skilled workers. But when it comes to doing this important work, states have been shortchanged and left in the lurch.

Here are the facts. Employers pay the FUTA tax, which is a dedicated tax for administering the unemployment insurance system, for the public employment service and for veterans' reemployment assistance, and for labor market information. For Ohio employers in FFY 1995, it was $259 Million. But neither the employers nor states are getting these funds back to provide services for which they were intended. For FFY 1995, Ohio received $102 Million from the FUTA tax. This means Ohio employers got back less than 39 cents on the dollar.

Ohio's **return on employer FUTA taxes** remains low, declining to **39% today**. *It's just like the highway trust fund.*

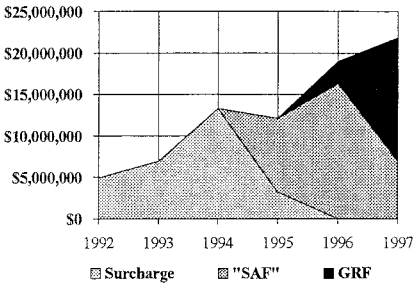


As our Governor related to you in May of last year, Ohio is not alone. Since 1990, less than 59 cents of every employer FUTA tax dollar has been returned to the states for funding employment security.

In Ohio, this shortfall in funding has resulted in the closing of 22 local employment service offices in the last four years, alone. Once, Ohio had nearly 120 offices where customers could get face-to-face service. Now, that's down to 57. Our Bureau of Employment Services has cut staff positions and is operating today at historically low staffing levels. Nearly every other state has had similar experiences. If there were a recession, Ohio would not have the capacity to respond.

Because these employment services are important to Ohio's economic health, the Ohio General Assembly has appropriated more than $50 Million in the past four years to pay for what FUTA funds were meant to support -- and which are already paid by employers. Ohio's taxpayers get shortchanged when state general tax money must prop up a system that should be funded by FUTA. Ohio's taxpayers are paying twice to fund a system that's inadequately financed by Congress.

***Ohio legislators have ponied up** income tax & employer penalty money, **to pay for service that Congress won't support** with FUTA funds*



The level of concern in Ohio's General Assembly about this is very high, and we have passed SCR. 10, a resolution asking our Congressional delegation for help. It specifically asks Congress to enact legislation to return adequate funds to states to fund the operation of the employment security system, and to give a fair return to employers for the taxes they pay under the Federal Unemployment Tax Act. Our delegation's positive response is obvious in their support of HR 3684.

HR 3684 corrects the currently-flawed system, and gives states the resources and tools they need to properly and adequately operate their employment security programs.

The bill gives employers a much fairer return for payroll taxes they pay. In addition, it repeals the FUTA surtax, whose original purpose has long been served. This provision will add an estimated $62 Million a year to Ohio's economy for job creation and business development and expansion.

Most important, HR 3684 will return to states the funding necessary to properly administer their employment security systems and services, which are the unemployment insurance program, employment services, labor market information and employment service to Veterans.
It increases overall funding available to states by up to 40 percent each year. For Ohio, that will mean $40 Million over present funding levels in the first full year of operation. And the bill eliminates the need for duplicative state add-on taxes to make up for FUTA funding shortfalls.

Because there is more funding available, the bill helps Ohio by giving us the tools for more rapid reemployment of claimants, and by distributing FUTA surpluses to state benefit accounts. As you

know, employers pay two separate "employment security" taxes: 1) FUTA; and 2) a state payroll tax collected by state employment security agencies under state laws. In Ohio, this tax is collected by the Ohio Bureau of Employment Services. The state payroll tax is used solely for unemployment benefits: to pay temporary income benefits to workers who are unemployed through no fault of their own and are actively seeking their next job. An employer's state unemployment tax is experience-rated according to formulae systems that vary from state to state. Generally, a poor experience, which is manifested by high employee turnover, results in a higher tax rate for that employer. State taxes are deposited into state trust funds managed by the Secretary of the US Treasury. Each state's tax rate and tax bas is determined by the legislature in the individual state.

In Ohio we do a good job of both (1) helping people find reemployment help and (2) keeping unemployment taxes reasonable. Ohio's trust fund is in the black. At the end of July 1997, Ohio had a balance of $2.105 Billion -- an amount which is well above a "safe level" of reserves. Last year, Ohio's unemployment tax rates were reduced significantly. This was the result both of a plan designed by our General Assembly in consultation with business and labor leaders years ago; and of careful tax administration, a health economy, and diligence in helping unemployment claimants obtain reemployment quickly. The average duration in Ohio for receipt of unemployment benefits is 13.6 weeks, down from 15.5 weeks in 1993. The impact on Ohio employers is enormously positive, reducing employers' state unemployment taxes by 27 percent on average and saving an estimated $210 Million. This is real money that can be used for job creation. Our employment security management in Ohio is effective and positive.

HR 3684 enables state legislatures to do more of the kind of work they already do. State legislatures, like Ohio's, are up to the task. For Ohio, our legislature already sets unemployment benefit and tax rates. Our General Assembly already annually invests "special administrative funds" or "SAF" money in our employment security system. Our General Assembly is already experienced at setting tax rates to pay off loans from the Federal government.

As you can see from our history of state support for our Bureau of Employment Services, our General Assembly is already experienced in deciding what amount of money is needed for employment service offices around the state of Ohio. My experience and work in the Ohio Senate committees tell me, when passing unemployment law and making appropriations too, our General Assembly is already experienced in handling FUTA conformity, and fully capable of spending FUTA dedicated funds only for FUTA's dedicated purposes. We are fully capable of properly budgeting, and in balancing budgets year after year. Our General Assembly is fully capable of the task of setting funds aside for extended benefit payments. Our General Assembly knows how to work with Governors, labor and business in building a first-class employment security system like we have in Ohio.

The Ohio General Assembly and other state assemblies need the resources HR 3684 can bring, so we can devote scarce state funds to competing policy priorities like education to build a world-class workforce. We'd appreciate your help in passing HR 3684.

F:\SHARED\TESTIMON\CUPP02F.WPD, June 22, 1998 (10:02AM)

Chairman SHAW. Thank you, sir.

Mr. Weisenburger.

STATEMENT OF JOSEPH WEISENBURGER, DEPUTY COMMISSIONER, NEW HAMPSHIRE DEPARTMENT OF EMPLOYMENT SECURITY

Mr. WEISENBURGER. Thank you, Mr. Chairman, Subcommittee members. My name is Joe Weisenburger. I'm the deputy commissioner of the New Hampshire Department of Employment Security.

H.R. 3684, a measure to reform the employment securities system, is not about power and control; it's about restoring the integrity of the unemployment insurance system and the Public Employment Service. It's about helping unemployed workers get back to work as quickly as possible. These programs have been devastated by budget cuts and mismanagement. The current system is inefficient; it's rule-bound, and it shortchanges employers and workers alike.

Budget shortfalls have led to errors in our system, errors that have caused overpayments and longer periods of unemployment duration. Both of those issues have raised employer taxes at the State level, and have caused unnecessary expenditures from the Federal Unified Budget.

Employers today are burdened unnecessarily with two tax systems for the same system, costing them hundreds of millions of dollars a year. Employment services to workers and to employers have deteriorated. The work test, a function necessary to determine an individual's continued eligibility for unemployment benefits, is a thing of the past in most States.

H.R. 3684 will reverse the negative direction our program is experiencing. It is a mechanism that would allow for adequate appropriations while at the same time having a minimum impact on the Federal budget. It consolidates employer tax filings into a simple tax, a single tax collected by the States, and, most importantly, it ties the Public Employment Service to the unemployment insurance system, ensuring that workers will be provided with re-employment services after experiencing unemployment.

Last year you reformed the welfare system. This year it is likely that the Congress will reform the job training program. Governors need the flexibility to manage both of these programs along with the unemployment insurance program, and to leverage the resources of these programs to provide the needed services at the State and local levels. Transferring the authority to collect the taxes and administer this program to the governors at the State level, and to the State legislatures, will allow us to make all three programs successful.

Finally, Mr. Chairman, I'd like to discuss how the employment securities system is funded by the U.S. Department of Labor. Section 302 of title 3 of the Social Security Act requires the Secretary of Labor to provide adequate funds for the proper and efficient administration of the State's unemployment compensation laws. As you know, employers this year will pay about $6 billion in FUTA taxes. Only 80 percent of that, $4.8 billion, will go into the administrative account. The administration's budget for this year is $3.7 billion; $200 million of that is for a one-time expenditure for the

year 2000 problem, leaving $3.5 billion available to the States for the proper and efficient administration of not only the unemployment insurance system, but the Public Employment Service, labor market information programs, veterans' programs, work opportunity tax credits, alien labor certification—a whole number of programs that support the workforce.

This year the President's budget is the same $3.5 billion. By the Department's own admission, the Fiscal Year 1998 appropriation for the unemployment insurance program is $305 million short of what is necessary for the proper and efficient administration of the State's unemployment compensation laws. The President's budget for Fiscal Year 1999 raises that to $365 million short.

If the Secretary has a lawful responsibility to request funds for the proper and efficient administration of the program from the Congress, why isn't the Department of Labor doing that? This shortfall is the result of the Department funding other initiatives for which there is no revenue in the Department of Labor's budget—programs such as School to Work, programs such as One-Stop Career Centers.

Mr. Chairman, bad things happen to people when they're unemployed. Families break apart; child abuse and spousal abuse increase; crime increases; drug and alcohol abuse increases; debt rises; families stop investing in their children's education; they stop volunteering. These are problems, social ills, that follow unemployment.

The employment security system works to relieve the workers of this terrible burden of unemployment. Why wouldn't this country invest fully in the employment securities system? This year 18 million unemployed workers, 1 out of every 7 workers in this country, went to the Public Employment Service looking for work. We were able to place 3 million of those 18 million. That means 15 million unemployed workers did not get help from the Public Employment Service because we did not have the resources to help them.

Thank you, Mr. Chairman.

[The prepared statement follows:]

TESTIMONY OF JOSEPH WEISENBURGER

DEPUTY COMMISSIONER

NEW HAMPSHIRE EMPLOYMENT SECURITY

RELATIVE TO HR 3864

TO

E. CLAY SHAW, JR.

CHAIRMAN

SUBCOMMITTEE ON HUMAN RESOURCES

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

JUNE 23, 1998

3:00 PM

Good afternoon Mr. Chairman and committee members. My name is Joseph Weisenburger, Deputy Commissioner of the New Hampshire Department of Employment Security. Thank you for the opportunity to express our views regarding this important proposed legislation.

Good paying stable jobs are the economic foundation of our towns, cities and our Nation. Our ability to compete worldwide, provide a stable US economy and worker job security require a well functioning state employment security system. However, because of the federal deficit and growing federal micro management the current system has become more rule bound and less efficient, short changing employers who use and finance the system and workers who use the program for temporary financial assistance and to find new jobs. The role of the federal government is the root problem. A prerequisite to making the needed fundamental changes is to shift or devolve the responsibility for program funding and administration to the states.

The current system is called a federal/state partnership. However, because the federal government controls the administrative funding lever, it controls the state activities. These activities, many of which are part of a federal agenda, are often inconsistent with a state's vision for its employment security system. The federal government's micro management of the system diminishes its efficiency and effectiveness.

Last year you reformed the welfare system by transferring more authority and responsibility to the states. This year the Congress will likely reform the Job Training system by block granting programs to the states. Both the Welfare system and the Job Training system rely on the state employment security system for employment services and important labor market information. Governors need the authority and flexibility to leverage the resources of these three workforce programs in a way that meets the needs of their state and its local labor markets. Transferring the authority for determining funding and program specifics for the Employment Security System from the federal government to the states as, HR 3684 does, will not only improve the efficiency and effectiveness of Employment Security programs but also those of the Welfare and Job Training programs.

HR 3684 is a consolidation of various state proposals to devolve the Employment Security system to the states. It addresses concerns raised by other stakeholders, most of whom want to preserve the federal/state partnership. The consensus reach by the states with individual proposals (Georgia, New Hampshire, Ohio and Virginia) increases the role of the states in the federal/state partnership. It is a reform proposal with some of the characteristics of devolution. The Issues leading to the proposal are:

- The Federal budget process causes insufficient state allocations even though the administrative trust fund (ESAA) is at its statutory ceiling and the funds can only be used for ES Administration.
- Administrative shortfalls lead to errors causing benefit overpayments and longer unemployment duration. This results in higher state employer taxes and an increase in the deficit.
- Employers are unnecessarily burdened with two separate tax and filing requirements.
- Federal oversight and micro management including cumbersome accounting and reporting procedures, inhibit efficient operation of state systems and
- Services to employers and unemployed workers have deteriorated.

The proposal addresses these issues by authorizing the state legislatures to make appropriations, from state specific accounts in the federal employment security administrative account (ESAA), that reflect the needs and workload of the state. It consolidates the FUTA tax filing and the state tax filing into a single tax filing. And, it strengthens the public employment services by tieing it more closely to the unemployment compensation program and gives the governors greater flexibility in establishing the role of the employment service in the state's workforce development system.

If passed this bill will transfer the administration and funding of the Employment Security System from the federal government to the states while retaining national interests and a minimal, but important amount of federal oversight. The proposal will not increase the federal deficit and in fact will increase tax collections through more efficient collection methods and save employers enormous amounts of time and money by consolidating tax filings. But more importantly, the reform will restore deteriorating services and program integrity.

As a state administrator I naturally have an interest in policy development, but my real concern comes from the effect that political decisions relative to employment and unemployment have on the day to day lives of millions of workers and their families.

We know that unemployment contributes to increases in crime, family breakups, spousal and child abuse, drug and alcohol abuse, home foreclosures, car repossessions and bad debt. It also reduces charitable contributions, community service, tax collections, new business startups, college educations and most importantly a worker's self esteem. These maladies cost us all a great deal of money. The problems of unemployment are poignantly described in the preamble to state unemployment laws.

"Whereas, economic insecurity due to unemployment is a serious menace to the health, morals and welfare of the people of this state, and involuntary unemployment is therefor a subject of general interest and concern requiring appropriate action by the legislature to prevent its spread and to lighten the burden which now so often falls with crushing force upon the unemployed worker and his family..."

This legislation is not about power and control. It is about stabilizing employment and working to minimize the hardship that accompanies unemployment.

The Employment Security system is an institution that has served this nation's workers and employers well over the past 60 years. But its ability to continue that service is in serious jeopardy.

Even with record low unemployment the states are stretched beyond their ability to effectively and efficiently run the program. About 7.5 million workers received unemployment benefits in 1997 and over 18 million, or one of every seven workers in the country, used the public employment service. What will we do when a recession occurs. The infrastructure will be gone.

On Thursday, 6/18, we received the preliminary allocations for FY 1999 from the Department of Labor based upon the President's budget. It cut State staffing levels an average of 6.24%, or about 2600 positions. New Hampshire had the highest cut in the nation, 10.79%. By the department's own figures, New Hampshire is currently funded 15% below this year's workload for base staff. An additional 10.79% cut will be devastating. In order to avoid closing offices and laying off trained and experienced staff, we have assessed employers with a state administrative tax which leaves them paying twice for the same service.

Title III, section 302 of the Social Security Act, requires the Secretary of Labor to fund the states with amounts "necessary for the proper and efficient administration" of the state law. That never happens. Instead, budget levels for the unemployment insurance and the employment service are held below the level needed by the states, so other special programs like "School-to-Work" and "One-Stop" Career Centers can be funded.

While these special programs may have merit, we strongly believe proper funding for proven core programs is more important.

Twenty-eight states currently support this legislation. After receiving the preliminary budget figures for next year, I expect additional states will join our coalition.

Mr. Chairman, we thank you and the co-sponsors for introducing this legislation and we urge the committee to approve it.

Chairman SHAW. Mr. Jamerson.

STATEMENT OF DOUGLAS JAMERSON, SECRETARY, FLORIDA DEPARTMENT OF LABOR AND EMPLOYMENT SECURITY

Mr. JAMERSON. Good afternoon, Mr. Chairman and members of the subcommittee. I am very pleased to be here today and to have this opportunity to testify before you on H.R. 3684——

Chairman SHAW. Douglas pull that mic to you, if you would, sir. Thank you.

Mr. JAMERSON [continuing]. The Employment Security Financing Act of 1998.

Let me begin my remarks by commending you, Mr. Chairman, for your prescience in sponsoring such a comprehensive reform package. H.R. 3684 will provide welcome relief to States such as Florida that receive a disproportionately low return of FUTA tax revenue.

H.R. 3684 represents a bold departure that holds the promise of a future in which the unemployment compensation system will be able to fulfill its mission in a rapidly-changing workplace.

We in Florida are blessed by a continuing strong national economy that supports the lowest level of unemployment in modern history. However, we would be naive to think that the cycle of growth will continue unabated. The very nature of work and one's relationship to the workplace is in the process of being redesigned. The dynamics of the employer-employee relationship is undergoing profound evolution. In this setting, the goals envisioned by H.R. 3684 could not come at a more opportune time.

I would like to discuss the provisions of H.R. 3684 with you in the context of the impact that I believe that they will have on the State of Florida and the system that I am charged with overseeing.

I don't know if I'm stopping, but you might have to stop for me [referring to the bells ringing]. [Laughter.]

As I understand it, major tenets of the bill would assign responsibility for collection of FUTA taxes to the State agency beginning in the year 2000. It would also authorize expenditures from State administrative funds of an amount not to exceed $245 million annually for Fiscal Years 2000 through 2003, subject to appropriation by the State legislature.

These administrative dollars could then be used to provide for collection of the FUTA tax; to more effectively, I believe, determine whether or not those claiming benefits have made themselves available or able for suitable employment; to provide job search and placement services, including job counseling, testing, occupational and labor forecasting; to enhance employees' skill assessment and referral to employers, and to appropriate recruitment services and technical assistance to employers.

Mr. Chairman and members of the subcommittee, this bill further provides for annual appropriation of 100 percent of the amount collected in both FUTA taxes and Reed Act monies to the States, beginning in Fiscal Year 2004, eliminating some of the caps that have been placed in the way.

It authorizes expenditures of up to 140 percent of the amount appropriated to the States from employment security funds for the

previous Fiscal Year, and it repeals the two-tenths of a percent FUTA tax, surtax, effective 2004.

You've heard it said here before, and I will reiterate, the repeal of this temporary tax fulfills the promise made to employers when it was originally enacted—that it is, indeed, a temporary tax, and that its goal was to, in fact, reduce the burden on employers by economic factors in place at the time. By shifting the tax collection process to the States, H.R. 3684 holds the promise of decreasing the administrative cost to employers by establishing the State agency as the sole point of payment; reducing or even eliminating paperwork, due to the filing of one State tax return versus both a State and a Federal return; providing more localized services, thus, assuring quicker response patterns to the specific needs of the taxpayer.

It is my opinion that allowing the States greater flexibility to appropriate administrative funds for unemployment compensation and employment services will lead to more efficient operation of the program, more exact tailoring of services rendered to the unemployed and job seekers, as designed by State legislators and the Executive Branch; a sharper focus by agencies on the business of employment, rather than dealing with budget shortfalls and administrative uncertainties that are inherent in the current system; a greater accountability by those charged with the mission of putting people back to work, and a direct link between the State appropriations process and the services rendered by the responsible State agencies.

I would like to mention that there are a few areas of H.R. 3684 that we believe need to be addressed. We believe that government plays a very important role in ensuring that unemployment compensation funds are dispersed properly. Clearly, this bill gives greater flexibility to integrate these programs into the workforce development system that we applaud, because in Florida we're moving very quickly in our workforce development effort. Our caution is that we do believe that eligibility and payment of unemployment compensation claims is inherently a function of government.

We encourage you to remember to maintain the integrity of the unemployment compensation and services program, the current safeguards that are needed to be maintained and strengthened to ensure that States cannot use unemployment benefits for administrative funding or other purposes.

Mr. Chairman, in closing, let me say that this committee I believe will have the ultimate responsibility for ensuring that the United States employment security program continues to fulfill its mission and remain focused on the needs of the people. The passage of H.R. 3684 will enhance the employment security program and allow States to individualize their own unemployment compensation programs to meet the needs of their own residents.

With that, Mr. Chairman, I want to again thank you for your offer to address the committee, and I'm available to answer questions that you may have.

[The prepared statement and attachments follow:]

Statement of Douglas L. Jamerson, Secretary, Florida Department of Labor & Employment Security

Hearing on the Employment Security Financing Act of 1998 (H.R. 3684)

Introduction

Thank you Mr. Chairman and members of the Subcommittee for inviting me to testify before you today. It is indeed an honor and privilege.

Let me begin my remarks by commending you, Mr. Chairman, for sponsoring such a comprehensive reform package. H.R. 3684 will provide welcome relief to states such as Florida that receive a disproportionately low return of FUTA tax revenues.

Background on Employment Security System

Since President Franklin D. Roosevelt signed the Social Security Act into law over 60 years ago, the federal-state Employment Security program has been one of—if not the—best-run government programs. The program has succeeded, in part, because of the cooperative spirit emanating from both the federal and state levels of government.

The Employment Security program serves millions of unemployed workers annually by providing partial income replacement, through unemployment benefits, when workers become unemployed through no fault of their own. Unemployed workers are therefore able to maintain some degree of purchasing power to pay for daily necessities such and food and shelter. In other words, the Employment Security program serves to cushion the devastating emotional and economic affects of involuntary unemployment.

In addition to providing partial income replacement, the Employment Security program assists unemployed workers and other job seeks in becoming re-employed though counseling, job search assistance, job referral and placement, and referral to training.

Businesses benefit from the Employment Security program too. They benefit from the stabilizing effect unemployment benefit payments provide to the economy. The Employment Security program also assists employers through screening and referrals of job applicants. Additionally, businesses receive vital labor market information that aids in planning and forecasting.

Employment services to veterans are also provided through the Employment Security program.

Employment Security Financing Act of 1998

The Employment Security Financing Act of 1998 will prepare the Employment Security program to meet the challenges of the 21st century. It would accomplish this feat by (1) empowering state legislatures to appropriate administrative funding for the Employment Security system; (2) assigning responsibility for collecting FUTA taxes to the states; and (3) repealing the 0.2 percent "temporary" FUTA surtax. In addition, the bill retains the core functions of the public employment service and veterans employment services.

State Appropriation of Administrative Funding

Putting aside the inherent problems associated with designating Employment Security financing as discretionary, the crux of the problem with funding the administration of the Employment Security program lies in the way funds are allocated to the states by the U.S. Department of Labor.

The inexplicable allocation of administrative funds, which is based in part on outdated workload formulas, has led to continued unfair allocations to Florida over the years. As shown in Chart 1, on average, Florida receives less than 34¢ on the dollar in the form of administrative grants for its Employment Security program.

Authorizing state legislatures to appropriate administrative funding will enable states to not only manage their services more efficiently, but also enhance services beyond those minimally required under federal law. State legislatures, aided by their governors and Employment Security agencies, are better positioned to determine the level of administrative funding needed to ensure the "proper and efficient" administration of their Employment Security programs.

State Collection of FUTA Tax

As Chart 2 illustrates, in 1996, Florida's Division of Unemployment Compensation, Bureau of Tax, collected an estimated $641.9 million in state unemployment taxes. That was double the amount of federal unemployment taxes collected from Florida employers by the Internal Revenue Service. Florida's recently redesigned tax system should assist the state in assuming the added responsibility of collecting a larger volume of tax revenues.

Not only is collection of unemployment taxes by both the federal and state governments inefficient; it's also costly. According to the Coalition for Employment Security Financing Reform, the Internal Revenue Service received roughly $100 million in fiscal year 1995 (the latest year in which figures are available) for collection of the FUTA tax. Collection costs should be lower under state collection of FUTA taxes as states reach economies of scale by taking advantage of structures already used to collect state unemployment taxes.

Repeal of 0.2 percent FUTA Surtax

The 0.2 percent surtax was enacted in 1976 to help repay the costs of federal extensions of unemployment benefits during the 70s recession. The repeal of this "temporary" tax will fulfill the promise made to employers when it was originally enacted—that it is indeed temporary.

Continuity of Employment Security Program

The integrity of the Employment Security program has withstood over 60 years of operation due, in part, to a properly maintained balance between the federal and state partners. Too much power in the hands of the federal partner would unnecessarily tie the hands of states and prevent them from continuing their role as the "Laboratories of Democracy." Too much power in the hands of the states and the program losses its national character and could lead to a "race to the bottom," as states compete against one another to attract and retain businesses through promises of lower tax burdens. Although this point is not entirely clear, Section 303 of the Act could potentially upset the delicate federal-state balance by tilting the scale too much in favor of the states.

Section 303 of the Act proposes to allow states to ignore the Secretary of Labor's interpretations of the "methods of administration" requirements under paragraph (1) of section 303(a) of the Social Security Act, including but not limited to requirements relating to quality control, if such interpretations impose additional administrative burdens on the states, unless Congress ratifies the Secretary's interpretation through legislative enactment.

While I can certainly appreciate the concern with the U.S. Department of Labor imposing costly administrative burdens on the states, I think the history of the program shows otherwise. In fact, continuity of the Employment Security program is maintained

by preserving the U.S. Department of Labor' current authority to interpret the complex laws governing the program combined with the power to advise the states of such interpretations.

Additionally, because state legislatures would exercise more control over administrative trust funds under H.R. 3684, it is important to maintain and strengthen current law provisions that serve to protect the public's interest by upholding the integrity of the Employment Security program. Current provisions, which ensure that state and federal unemployment taxes remain dedicated for the purposes in which they were paid, should be maintained. Care must also be taken to maintain the public's confidence that decisions affecting important due process rights will not be based on profit motives. Functions that are "inherently governmental functions," such as determining benefit eligibility, should remain within the exclusive domain of public institutions responsible for administering public policy.

Adequate Transition Funding for states and U.S. Department of Labor

Let me add that I believe it's imperative that this legislation ensures adequate funding for states to make the transition to collecting FUTA taxes. Not only will new tax forms need to be developed, but also computer hardware and software will need to be upgraded and programmed to handle the increased load of processing federal taxes.

Conclusion

I believe that if the Employment Security System is to survive and fulfill its mission of providing essential services to its primary customer base of unemployment claimants and other job seekers, employers, and veterans; Congress must act swiftly to reform the administrative funding of the system. This will help to resolve the long-standing contention between the states and the federal government and continue the cooperative spirit that has helped the system to operate successfully for over 60 years.

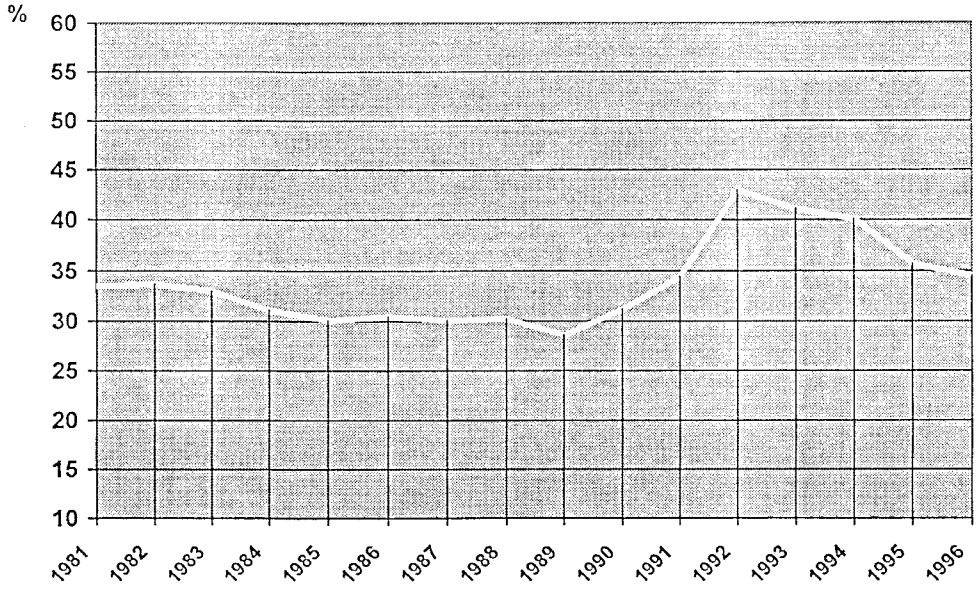
Chart 3. Florida Unemployment Program Statistics

Year	Civilian Labor Force (Millions)	Number of Liable Employers	State U.C. Taxes Collected[1] (Millions)	Benefit Payments[1] (Millions)	FUTA Taxes Collected[1] (Millions)	Admin. Grants[2] (Millions)	Percentage of FUTA Taxes Returned as Admin. Grants
1981	4.5	219,073	192.4	170.3	135.5	45.4	33.5
1982	4.8	225,234	187.9	335.3	140.0	47.2	33.7
1983	4.9	236,086	253.7	296.8	164.7	54.3	33.0
1984	5.1	250,491	373.7	221.6	200.3	62.2	31.1
1985	5.3	266,370	357.5	246.5	210.9	63.4	30.1
1986	5.6	275,623	312.7	290.6	221.6	67.4	30.4
1987	5.9	286,670	297.7	261.2	236.2	71.1	30.1
1988	6.1	296,283	291.1	277.1	252.1	76.1	30.2
1989	6.2	306,721	287.4	278.2	266.4	76.2	28.6
1990	6.5	311,377	251.4	460.3	269.1	83.9	31.2
1991	6.5	315,442	305.3	801.4	270.3	93.1	34.4
1992	6.6	320,089	466.9	824.3	270.0	116.0	43.0
1993	6.7	330,027	618.3	667.0	281.1	115.6	41.1
1994	6.8	336,697	699.7	683.7	290.7	116.7	40.1
1995	6.9	343,017	694.1	634.5	319.1	113.8	35.7
1996	7.0	348,339	641.9	639.2	321.5	110.8	34.5

[1]Source: ET Handbook 394

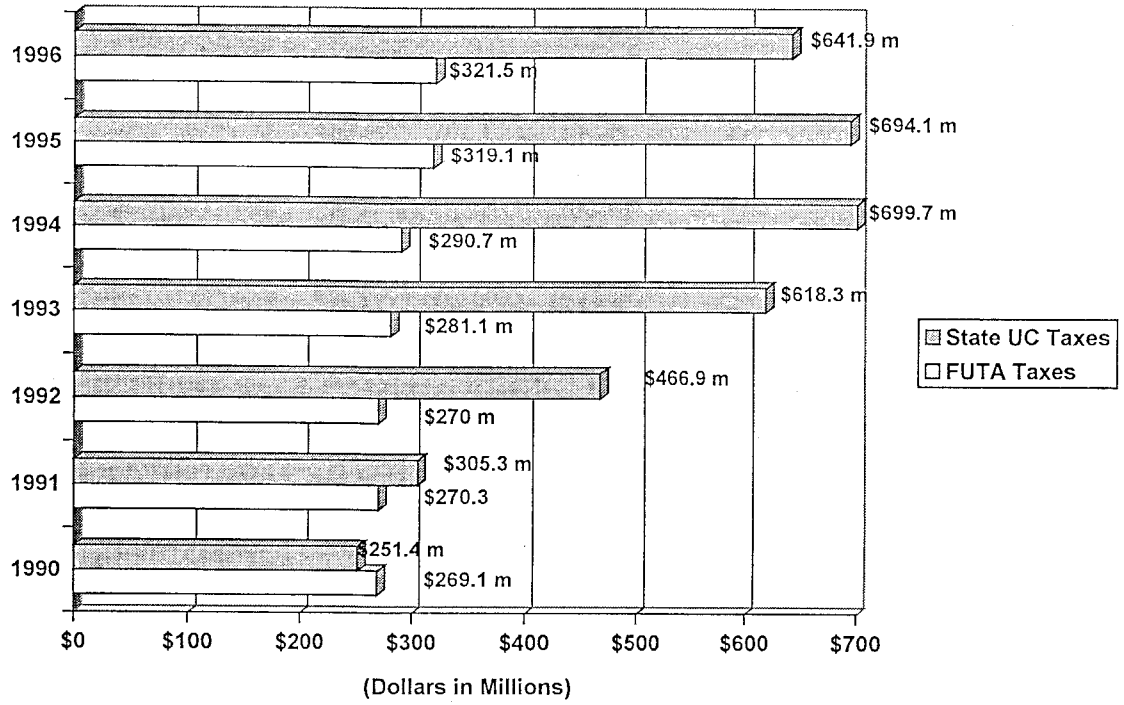
[2]Source: U.S. Department of Labor, Unemployment Insurance Program Letter (UIPL) No. 24-98 (April 27, 1998).

Chart 1. Percentage of FUTA Tax Revenues Returned to Florida as Administrative Grants



Source: U.S. Department of Labor, Unemployment Insurance Program Letter (UIPL) No. 24-98 (April 27, 1998)

Chart 2. State and Federal Unemployment Taxes Collected from Florida Employers (1990-1996)



Chairman SHAW. Thank you, Mr. Jamerson, for a very fine statement.

Dr. Norwood.

STATEMENT OF JANET NORWOOD, SENIOR FELLOW, THE URBAN INSTITUTE

Ms. NORWOOD. Thank you, Mr. Chairman. As you all know, I spent three years chairing the Advisory Council on Unemployment Compensation, having been appointed by both the Republican and Democratic President, and I've also served more than 13 years as Commissioner of Labor Statistics with responsibility for the country's Federal/State labor market information system.

The UI program is now more than 60 years old, is one of the most important examples of effective cooperation between two levels of government with shared responsibility. Although the overall unemployment rate for the country as a whole is relatively low and job growth remains quite strong, more than 20 States still have rates higher than the national average. We know also that the proportion of total unemployed who received unemployment benefits has fallen over the last several decades.

The solvency of the State UI trust funds must remain a matter of real concern. If the unemployment insurance program is to meet its twin objectives—to promote economic stability and to provide temporary assistance to workers with job detachment who lose their jobs through no fault of their own—it is important that States accumulate reserves during periods of economic health that are sufficient to pay benefits during economic recessions.

But, by the end of last year, State trust fund reserves were only about 80 percent of the levels they were at just before the last recession. Instead of building up trust fund reserves during these current good times, last year alone 16 States reduced unemployment insurance taxes.

It is clear that the States have the important responsibilities and powers in the administration of the UI program, and I believe they should continue to have them. However, our research demonstrated that increasing competitive pressures on the States has at times caused a tightening of eligibility standards, resulting in a reduction in coverage. These conditions have caused a race to the bottom among some States, affecting especially trust fund solvency and the treatment of low-wage workers.

Of course, some States have maintained a sensible degree of forward-funding, but some States have not. In those States which do not, one extremely important purpose of the UI program, the provision of purchasing power during economic downturn, just does not work. State trust funds must be adequately funded in good times, so that funds are available for payment to workers in recession times. I am concerned that H.R. 3684 provides little Federal role for working toward trust fund solvency.

Our research also found that competitive pressures among the States to attract business could lead to a continued decline in the proportion of workers who receive benefits, disproportionately affecting low-wage workers. Those working part-time are especially hard-hit. I believe that it is important to ensure that a low-wage worker not be required to work more hours to qualify for benefits

than a higher-wage worker. H.R. 3697 deals with this issue, but H.R. 3684 does not.

Finally, as I'm sure you are aware, Mr. Chairman, I have a very real interest in any action that could affect the Federal/State statistical system. I'm pleased to see that H.R. 3697 takes note of the importance of labor market information, but I am concerned about the effect of the proposed change and the manner in which the statistical programs are funded. I believe that this change could damage most of the most important national and State economic intelligence that the country produces.

I could review all the programs, but I won't do that now. It's sufficient to say that these data are extremely important. I am concerned that H.R. 3684 makes the appropriation of much of the funding, apart from whatever comes out of the 2 percent setaside, to administer the important State activities, to produce State and national data, dependent on the legislatures in each of the States and other jurisdictions.

We should not put programs such as this in jeopardy by making them dependent on the likelihood that 53 different jurisdictions would each year appropriate the funds required to maintain the quality and consistency of the national data. If they do not, and the history of this Nation's statistical system suggests that this is a very real possibility, the country's entire system of labor market statistics would suffer. Some State data would be inconsistent with those in other States producing national data of poor quality. Indeed, the Federal Government might be forced to mount new national surveys which would inevitably increase respondent burden as well as cost. I urge you to reconsider the bill's treatment of the method of funding for these programs.

Mr. Chairman, I appreciate this opportunity to be here, and I'd be glad to try to answer any questions.

[The prepared statement follows:]

TESTIMONY OF

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before the

Subcommittee on Human Resources
Committee on Ways and Means

JUN 23 1998

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to be here this afternoon to discuss the future direction of the nation's unemployment compensation program (UI). As you know, I chaired the Advisory Council on Unemployment Compensation (ACUC), having been appointed by our last two Presidents, one a Republican and one a Democrat. During that 3-year period (1994-96), the Council reviewed all aspects of the UI program, visited many state offices, and discussed the program with business and the general public. I also served more than 13 years as Commissioner of the Bureau of Labor Statistics, which has responsibility for the country's extensive federal-state cooperative labor market information systems.

The UI program, now more than 60 years old, is one of the most important examples of effective cooperation between two levels of government with shared responsibility. While I have not yet had an opportunity to examine the two bills before the subcommittee (H.R.3684 and H.R. 3697) in sufficient detail to comment on specific technical sections, I have read the two bills, and I should like to offer some comments on the direction the program should take in the future.

First, although the overall unemployment rate of 4.3 percent for the country as a whole is relatively low, and job growth remains quite strong, more than 20 states still have rates higher than the national average. Several states have jobless rates of 6.0 percent or higher. We know also that the proportion of the total unemployed who receive unemployment benefits has fallen over the last several decades. During the 1990's, this recipiency rate has been only about 35 percent.

Second, the solvency of the State UI trust funds must remain a matter of real concern. If the Unemployment Insurance program is to meet its twin objectives – to promote economic stability and to provide temporary assistance to workers with job attachment who lose their jobs through no fault of their own – it is important that states accumulate reserves during periods of economic health that are sufficient to pay benefits during economic recession. Yet, my colleague at the Urban Institute, Wayne Vroman, found that by the end of last year, state trust fund reserves were only about 80 percent of the levels they were at just before the last recession. Instead of building up trust fund reserves during these current good times, last year alone (in 1997) 16 states reduced UI taxes.

It is clear that the states have important responsibilities and powers in the administration of the UI program, and I believe that they should continue to have them. In fact, the Advisory Council made a number of recommendations to that end. However, our research also demonstrated that increasing competitive pressures on the states has at times caused a tightening of eligibility standards, which has resulted in a reduction in coverage. These conditions have caused a "race to the bottom" among the states, affecting especially two important areas – trust fund solvency and the treatment of low-wage workers. Of course, some states have maintained a sensible degree of forward funding, but some states have not. In those states which do not do so, one extremely important purpose of the UI program – the provision of purchasing power during

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[1] Any opinions expressed herein are solely the author's and should not be attributed to the Urban Institute, its officers, or funders.

economic downturn – just does not work. State trust funds must be adequately funded in good times so that funds are available for payment to workers in recession times. I am concerned that H.R. 3684 provides little or no Federal role for working toward trust fund solvency.

Our research also found that competitive pressures among the states to attract business could lead to a continued decline in the proportion of workers who received benefits, disproportionately affecting low wage workers – indeed, the working poor who are in most need of UI benefits during a period of temporary unemployment. Those working part time are especially hard hit – and, today, of course, a significant portion of the labor force have part-time jobs. The Advisory Council's research found, for example, that in a number of states, a person paid at the minimum wage who worked 20 hours a week the year round would not qualify for UI benefits whereas a comparable part-time full year worker paid at a higher rate would qualify in all states. I believe it is important to ensure that a low wage worker not be required to work more hours to qualify for benefits than a higher wage worker. H.R. 3697 deals with this issue, but H.R. 3684 does not.

Finally, as I am sure you are aware, Mr. Chairman, I have a very real interest in any action that could affect the federal-state statistical system. I am pleased to see that H.R. 3697 takes note of the importance of labor market information, but I am concerned about the effect of the proposed change in the manner in which the cooperative statistical programs are funded. I believe that this change could damage much of the most important national and state economic intelligence that the country produces. The employment, hours, and earnings survey program, for example, based on some 80 years of experience of federal and state governments working together, produces data of high quality that are used both by the states and the federal government. National data must be based upon consistent definitions, collection procedures, and statistical standards so that they can be aggregated to produce information for the country as a whole. These data are used to compile the nation's gross domestic product. From these data, we also learn about employment changes each month and about the shift among individual industries that occurs in each state and for the nation as a whole. This is a time when these data have become especially important to assist in the evaluation of the possible wage-induced inflation that worries our financial markets.

I am concerned that H.R.3684 makes the appropriation of funds to administer the important state activities to produce state – and national data – dependent on the legislatures in each of the states and other jurisdictions – 53 in all. We should not put programs such as this in jeopardy by making them dependent on the likelihood that 53 different jurisdictions would each year appropriate the funds required to maintain the quality and consistency of the national data. If they do not – and the history of this nation's statistical system suggests that this is a very real possibility – the country's entire system of labor market statistics would suffer. Some state data would be inconsistent with those in other states, and the data for the nation as a whole would suffer. It would no longer be useful as a part of our system of economic intelligence for the country as a whole. Indeed, the federal government might be forced to mount new, national surveys which would inevitably increase respondent burden as well as costs. I urge you to reconsider the bill's treatment of the method of funding for these programs.

Mr. Chairman, I appreciate this opportunity to appear before this subcommittee. I would be happy to answer any questions you or your colleagues might have.

List of References:

Advisory Council on Unemployment Compensation, *A Report to the President and the Congress,*
"Report and Recommendations," February 1994:
"Unemployment in the United States: Benefits, Financing, Coverage," February 1995;
"Defining Federal and State Roles in Unemployment Insurance," January 1996;
"Collected Findings and Recommendations: 1994-1996."

U.S. Congress, 2d Session, H.R. 3684: To amend the Internal Revenue Code of 1986, the Social Security Act, the Wagner-Peyser Act, and the Federal-State Extended Unemployment Compensation Act of 1970 to improve the method by which Federal unemployment taxes are collected; to improve the method by which funds are provided from Federal

unemployment tax revenue for employment security administration, and for other purposes.

U.S. Congress, 2d Session, H.R. 3697: To enhance the Federal-State Extended Benefit program, to provide incentives to States to implement procedures that will expand eligibility for unemployment compensation, to strengthen administrative financing of the unemployment compensation program, to improve the solvency of State accounts in the Unemployment Trust Fund, and for other purposes.

Vroman, Wayne, *Effects of Welfare Reform on Unemployment Insurance*, The Urban Institute, Series A, No. A-22, May 1998.

Chairman SHAW. Thank you, Dr. Norwood.

As some of our regular attendees here know, those buzzers mean that we've got to go down and vote, and there's two votes on the floor. I hope all of our witnesses on this panel and the next panel can stay. The Members, we will be gone for approximately 15 minutes, and so we will stay in recess until that time.

[Recess.]

Chairman SHAW. If you could be seated, we will commence the hearing.

Mr. Levin, to inquire.

Mr. LEVIN. Well, it's an interesting panel. I think there's basic agreement we want to try to reduce paperwork where we can and we don't want employers paying unnecessary taxes. Hopefully, we can have an open dialogue where we go from here without too many pre-set positions. One thing that would be helpful is if we get the facts—if we get a common understanding of the facts.

It was mentioned that the administration's request would underfund the needs. I think the facts are that the appropriations for several years did not meet the administration's requests. Therefore, the administration reduced its request. Also, the reference, I think, Mr. Cupp, about the employment services, the underfunding, there's been a big argument here about the funding of the employment service and I think you need to study the history of that. Indeed, at one point, there was a proposal, the previous administration's, to abolish the employment service.

But let me just ask, and I want it to be as constructively as possible, but you mentioned, Mr. Jamerson, about the need to individualize to meet the needs of our citizens and, with the welfare reform bill as we finally worked it out, there was flexibility within the States, but within some parameters, a requirement to meet health needs, daycare needs, a maintenance-of-effort provision. We worked it out.

Now I think each of these programs has its own characteristics. But individuality is one thing, but meeting responsibilities is something else. Unemployment in one State affects another and, indeed, unemployment in one State calls upon the Federal Government—other States—to help out. And the three of you come from States that, in terms of certain markers, are way below the norm. And the question is: How much individuality do we want?

For example, recipiency rates—that's the percentage of the unemployed who receive benefits—New Hampshire, you compare it with my State of Michigan, your—New Hampshire is far less than even half of the recipiency rate of Michigan and you're near the bottom. And Florida isn't much better. You're half of—you're better than half, but you're 20 points—percentage points—below Michigan. And Ohio's a bit better on recipiency rates, but when it comes to solvency, you're, I think, Mr. Cupp, in pretty bad shape, aren't you? This chart shows you—you're at .63. You have six-tenths of a year—I think that's what it means—to—you'd have sixty three-one hundredths of a year. I think these are accurate figures, and in terms of replacement rates, the percentage of wages that's replaced, Ohio and New Hampshire are very low.

Now, I mean, I want us to take a fresh look at this, but I think we want some flexibility for the States, but isn't there also a level of responsibility incumbent on the States. Yes, all three of you.

Mr. CUPP. Mr. Chairman, Mr. Levin, in terms of the solvency issue, it seems to me that the benefit issue is really a little different issue in regards to this bill in terms of my testimony, because States have historically set their benefit levels and this bill wouldn't change that. In terms of solvency—and I don't know what chart you're looking at——

Mr. LEVIN. Well, this is from the unemployment insurance service and it's the calendar year 1997 and it has Ohio at .63. You're tenth from the bottom.

Mr. CUPP. We have a $2 billion surplus and we have, in terms of our rate structure, we have automatic triggers that go into effect when there isn't a sufficient safe level in our fund. And this was agreed to by the legislature and by business and labor interests years ago. And so when there is a need to replace the fund or to add additional money to it, the rates—increased rates automatically trigger and the money will go into the system. So we believe we do have a sufficient safe level.

Mr. LEVIN. Well, I mean, there can be agreement in the State. That's part of the dilemma of one proposal. It would let every State set its solvency rate and it's interesting, here New Hampshire has a much higher solvency strength. In fact, it's more than three times Ohio and what that means is that essentially every State sets its own solvency rate and when it gets into trouble, you come looking here. I think that's what it means.

And we've been through the pain of regional recessions. Each of you should understand that. Surely you should, from Ohio, and I think Florida, which came later. And we had immense difficulty responding to that because only a number of States were impacted and we had to convince the majority of States to cough up their taxpayers to pick up, through Appropriations, the funding so there would be loans available and so that there would be extended benefit.

So—and I'll finish, Mr. Chairman—I think we need very much to take a fresh look, that we've got to look at the blend, and I'll finish. If you look, Mr.—you talked about what you're getting now in FUTA return, 38 percent. In 1992, Ohio got 188 percent. New Hampshire got 154 percent. Florida got 205 percent. You got double what you paid in because of the recession and I think we ought to dig out what the figures were for 1983 and 1984 in Michigan and Ohio and States that were impacted, what we got back compared to what we paid in. Because the recession of 1983, 1984, 1985 was much, much more severe.

And our fund, our proposal, will increase the returns to States for FUTA. That should happen. But there is an insurance principle that has to be built in here.

Chairman SHAW. In looking at the chart that you've been referring to, it's not a snapshot, it's a chart that goes back during the last recession. Mr. Weisenburger, are you familiar with this? And would you like to comment on that?

Mr. WEISENBURGER. Yes, I am. The chart that covers the 1991, 1993 recession includes about $12 billion under the Extended

Emergency Unemployment Compensation Act, which was a Federal—100 percent federally funded extension of unemployment benefits because the extended benefit program that the States run did not work. So this was not a return of FUTA dollars to the States, as the Department said. An additional $16 billion came from Federal General Revenue. The $12 billion balance in the EUCCA Account was literally stolen from the EUCCA Account to fund EUC, the emergency unemployment compensation program, simply because the Extended Benefit program, as it's currently written, didn't work—only worked in nine States. And the Congress, being very concerned that the program didn't work, passed an Emergency Unemployment Compensation Act and the $12 billion from the EUCA account is being included in the Department's documentation and called a return on FUTA revenue to the States when, in fact, it was not. New Hampshire received no money from the Federal Extended Benefits program.

Chairman SHAW. I think, you know, that just throws these figures out. They're just totally—they have no application. But what I would like to do is to have our staff come up with a year-by-year chart to chart these amounts for these States so we can really take a close look at it and take out the special appropriation that was made at that time. So we do have honest figures to look for and then we can go back and look at it because it's something that we should be concerned about.

Dr. Norwood.

Ms. NORWOOD. Yes.

Chairman SHAW. I share your views on the importance of maintaining good data about the unemployment benefit receipts and other labor market information. How can we best make sure that the data is still available if we do press ahead with H.R. 3684?

Ms. NORWOOD. Well, I'm not sure, because what your bill does, really, is to return to the States for purposes of unemployment insurance, the money, the 2 percent setaside is relatively small considering that it goes to the Secretary of Labor to do the—whatever—oversight, and I think that everybody agrees there should be at least some reporting to the Federal Government and the IRS and a variety of other programs.

The Bureau of Labor Statistics gets about $53 million in the latest budget for the Federal/State programs. All of that goes to the States. I mean, BLS is a pass-through. The Congress approves this. It goes into the BLS budget. BLS turns all of that money over to the States. It retains none of it. I don't see how, out of the 2 percent set-aside, the Secretary of Labor could possibly take $53 million out of about—what—$120, I hear, and put it into statistics.

Therefore, what would happen is that you'd have to go to every—every State would have to go to its own legislature and I can just tell you that what would happen is some States would approve it and some wouldn't.

Chairman SHAW. Well, how much would it take?

Ms. NORWOOD. Well, for this year, it's about $53 million, as I understand it, that the States get. I'm not—I don't know what it would be next year or what it was last year. But this is something that's agreed to between the Bureau and the States. But I think it's indicative of the kinds of problems that exist when you have

a set-aside. The other point is that that whole fund could go down if the taxes are reduced, of course. And, as I pointed out, 16 States have reduced the tax.

So I'm very concerned about that. There is some confusion, I think, because it comes in and—the labor market programs come in in several places in the law. But the problem is the amount that is there. And it's indicative of what is happening, really, when you take a set-aside of a fixed pot of money for some very good programs that exist. I mean, I recognize that statistical programs have to take their lumps with everybody else. We've done that. But I'm very worried about this, because I'm afraid that what it will do is increase the burden on respondents.

Chairman SHAW. Mr. Jamerson, how do you explain the slow return that the State of Florida gets on the unemployment taxes paid?

Mr. JAMERSON. Mr. Chairman and Mr. Levin, I think the slow return on the investment is, again, a factor—and I'm learning this. My UI director is here with me—based upon what I think this bill—one of the things this bill attempts to address is the formula, the formula that currently exists is arcane and perhaps needs to be revisited in some fashion. And that's what I would expect part of your legislation to do; look at this formula. The recipiency rate, as I understand the recipiency rate, that's only one factor that's brought into the equation to determine the amounts. And, as far as Joe said, the EB, as I understand the situation, Florida won't be triggered by it.

So we would hope that, as the discussion evolves around your legislation, your good legislation, there would be a way to look at this formula which has, I believe, outlived its usefulness, Mr. Chairman, and that's part of Florida's problem in getting our—what we call a fair share.

Chairman SHAW. Thank you.

Mr. LEVIN. Let me just take a few minutes if I might to finish this off. Do you favor the improvement in the triggers in the bill that Mr. English and Mr. Rangel and I have proposed?

Mr. CUPP. I'm not familiar with them.

Mr. WEISENBURGER. We believe that changes need to be made in the extended benefit program that allow the program to work in States that have a need to extend benefits. In New Hampshire, we just recently passed a total unemployment rate trigger on top of a trigger that doesn't work. We have not triggered on an extended benefit since February of 1981. This year our legislature enacted what it is in H.R. 3697.

Mr. LEVIN. Okay.

Mr. JAMERSON. I'm not that familiar with them either, Mr. Levin.

Mr. LEVIN. All right. Let me just say that—I take it that's more or less yes. You know, the problem is that your proposal has no improvement in the Extended Benefit program. There isn't one, except as the States would provide it, as I understand it. And let me just say something—and Mr. Shaw, I think it would be good to look at these, at the figures, because, you know, we tried for years to improve the Extended Benefit program and it was those improvements were opposed by the people who are sponsoring Mr. Shaw's

bill. We fought like the dickens to do that and we could not get the votes. And I think it reflects, Mr. Jamerson's, your statement, "too much power in the hands of the States and the program loses its national character and could lead to a race to the bottom." But, you know, if we had improved the trigger, Mr. Shaw, these figures——

Chairman SHAW. By the way, my bill does have the Extended Benefit provision in it. So your character——

Mr. LEVIN. With any improvement in the trigger?

Chairman SHAW. It continues the way it is. Our bill attacks the administrative problem, which I think you would admit is a nightmare and it's a damn waste of money.

Mr. LEVIN. I think there are real problems. I don't think you want to destroy the partnership in doing so. And all I can say is, if there had been an ample trigger mechanism, these figures of 205 for Florida in 1992, 154, and 188 would have been probably more or less the same, except instead of the money coming from the General Treasury, Mr. Weisenburger, they would have come from the unemployment funds.

And so we'll take a look of these figures, but if there had been an appropriate trigger that some of us had fought for for years, I'm not sure you wouldn't have received much more in 1992 than you paid in, because you would have triggered. So you ought to be in here fighting to change and improve the trigger mechanism. That's what you should be doing, in addition to straightening out the administrative programs.

Chairman SHAW. You through? [Laughter.]

Okay, I would like to—perhaps someday you will share with me these figures that are fed to you by the administration that we don't get. Well, I didn't get them. I don't know where you got them.

Mr. LEVIN. Oh, no, no. They're not Fed—I mean—what? They're published figures. I mean, they're not fed to me by anybody. I just read them.

Chairman SHAW. Just pull them out of the air, I guess.

Okay, lady and gentlemen, I appreciate your testimony.

Mr. LEVIN. Thank you.

Chairman SHAW. Now we will bring our final panel. Mr. William Petz, Jr., manager, Payroll and Unemployment Taxes, USX Corporation, Pittsburgh, Pennsylvania; Mr. John P. Davidson, staff attorney, Chrysler Corporation, Auburn Hills, Michigan; and Marc Baldwin, who is the assistant director of the Public Policy Department of American Federation of Labor and Congress Industrial Organizations.

Excuse me for laughing, but it's interesting to note that, two chairs down, the man from labor sits. [Laughter.]

Well, we might have a standoff.

Mr. LEVIN. Actually, there are good relationships between them.

Chairman SHAW. Mr. Petz.

STATEMENT OF WILLIAM PETZ, JR., MANAGER, PAYROLL AND UNEMPLOYMENT TAXES, USX CORPORATION, PITTSBURGH, PA

Mr. PETZ. Thank you, Mr. Chairman.

Chairman SHAW. And again, I have all of your full statements which will be made a part of the record.

Mr. PETZ. Good afternoon to you, Mr. Chairman and Mr. Levin.

Again, my name is William Petz, Jr. I am manager of the payroll and unemployment compensation taxes for USX Corporation, a major worldwide producer of steel products, energy, and oil and gas, headquartered in Pittsburgh, Pennsylvania.

I thank you for the invitation to speak today in support of H.R. 3684, the Employment Security Financing Act of 1998. USX would like to take this opportunity to commend Chairman Archer and especially you, Mr. Chairman and cosponsors for this historic step in advancing the reform of the Federal Unemployment Tax administrative finance process.

Over the years, USX has been at the forefront in support a sound and efficiently run State UC program. Our company believes that H.R. 3684 will bring those characteristics back to the program. As you know, State UC administrative expenses are funded solely by FUTA dollars and the funding level must be such that claim processing and job search services for the unemployed individual are not jeopardized by the underfunding of Congress.

However, in recent years, Congress has funded less than 100 percent of the State UC administration costs and this has resulted in a serious deterioration and service for employers, unemployed workers eligible for benefits, and other job seekers. Annual FUTA payments by employers total nearly $6 billion. The Congress has been appropriating only about 60 percent or $3.5 billion.

This lack of sufficient funding has forced the State UC agencies to cut critical services that affect the unemployed worker, such as work search and counseling. It has also decreased the State's ability to monitor and prevent fraudulent UC payments. In addition, various States have taken it upon themselves to fill the deficiency in funding by Congress to enact over $200 million in supplemental State payroll taxes on business. In effect, USX and other employers are paying for UC administration costs via three forms: FUTA tax, through State supplemental payroll taxes, and through inflated UC tax rates by longer benefit durations.

This is particularly frustrating for employers given that the FUTA trust fund accounts contained over $19 billion at the end of Fiscal Year 1997 that was primarily being used to offset general spending by Congress. H.R. 3684 will end that kind of productive over-collection of more than $2 billion a year in FUTA taxes. It will assign the responsibility for the collection, reporting and appropriation of FUTA tax to the States.

USX believes that with additional administrative financing, the State's will be encouraged to run a more efficient UC benefit and employment service program for the unemployed individual without taking anything away from current claimant rights and privileges or veterans or LMI statistics.

USX strongly supports H.R. 3684 for the following reasons: Sufficient funding for administration of State UC programs will be provided.

The FUTA surtax of two-tenths will be repealed after the year 2003. An example of how it affects an employer, USX currently pays a surtax of over $.5 million each year. Just to pay for this temporary surtax obligation, USX must sell about $7,100 tons of

steel products and over $100,000 of equivalent barrels of refined oil products.

H.R. 3684 will eliminate the need for that $200 million of State supplemental taxes. It will also promote lower UC spending and taxes, because each State will become the tax collector, the appropriator, and the overseer of how the employers FUTA tax is used.

The bill will eliminate the duplication and collection of reporting of UC taxes. It is estimated to save employers most of the $100 million which is annually being paid to the U.S. Treasury by the FUTA administrative fund for these services.

And finally, H.R. 3684 will codify the quarterly payment of FUTA and State UC taxes. USX does not support the administration's Fiscal Year 1999 proposal to pay and support FUTA and State UC taxes monthly, which is nothing more than a gimmick that does not actually raise any new revenue. More importantly, if the administration's proposal were enacted, it would triple the reporting for USX. Presently, it costs about $7,000 for us to make our reports and deposits of FUTA tax and State UC taxes. It would triple that burden to around $21,000. It would also place another unfunded mandate on employers and States.

In summary, USX supports H.R. 3684 because it finally addresses the problem of underfunded administrative financing for State UC programs. It will allow each State to control its own UC program with sufficient funds being provided to pay out UC benefits to the jobless and deliver needed work search assistance to unemployed individuals while maintaining the program's integrity. It is definitely a win-win-win proposition for employers, the jobless, and State UC agencies. Employers FUTA dollars will be used as it was intended.

This, Mr. Chairman, ends my prepared remarks.

[The prepared statement follows:]

Statement in Support of H. R. 3684, "Employment Security Financing Act of 1998", before the House Ways & Means Human Resources Subcommittee on behalf of USX Corporation by William Petz, Jr. on June 23, 1998.

Good afternoon, Mr. Chairman and members of the committee. My name is William Petz, Jr, and I am the Manager of Payroll and Unemployment Compensation Taxes for USX Corporation, a major world-wide producer of steel products, energy, and oil and gas, headquartered in Pittsburgh, Pennsylvania.

I thank you for the invitation to address the Committee this afternoon about USX's strong support for H.R. 3684, the "Employment Security Financing Act of 1998". USX would like to take this opportunity to commend Chairmen Archer and Shaw and co-sponsors for this historic step in advancing the reform of the Federal Unemployment Tax Act (FUTA) administrative financing process.

USX has been at the forefront in supporting a sound and efficiently run state unemployment compensation (UC) program which has the objective of providing temporary assistance to a person who through no fault of his or her own is laid-off from work and needs short-term assistance while he or she seeks a new job.

As the state UC program administrative expenses are funded solely by FUTA dollars, the funding level must be such that claims processing and job search services provided to the unemployed workers are not jeopardized by Congress's under-appropriation of funds to finance administrative costs.

As you know, the Nation's Federal/state UC programs are financed by two payroll taxes on employers; the first being a state UC tax, and the second, a Federal UC tax (FUTA). USX, which has over 37,000 employees across the United States annually pays about $8.2 million in state UC taxes to fund state unemployment benefit trust fund accounts. Funds generated from these taxes are made available to laid-off workers to pay for UC benefits. In addition, USX pays a FUTA tax of $2.5 million, to provide funds for appropriation by Congress to finance all of the administrative operating costs of providing (1) state UC benefits, (2) employment services for the jobless, (3) veteran's services, and (4) the U.S. Labor Department's unemployment insurance service.

However, in recent years, Congress has funded less than 100% of the operating costs related to state UC administration and employment services, which has resulted in a serious deterioration in services to employers, unemployed workers eligible for UC benefits, and other job seekers. Annual FUTA payments by employers total nearly $6 billion, but Congress has only been appropriating approximately 60% of that amount, or $3.5 billion, to state UC agencies to cover their administrative costs. The lack of sufficient funding has forced the state UC agencies to cut critical services that affect unemployed individuals. The reduction in service has caused untimely and

inefficient assistance in the rehire process, an increase in the number of benefits weeks paid to the jobless and a decrease in the ability to monitor and prevent fraudulent payments. In addition, it has forced state UC agencies to cut critical services, such as counseling, testing, and referral to employers.

Also, states have taken it upon themselves to fill the deficiency in funding by enacting supplemental state payroll taxes on business. At present, states are using over $200 million in state funds for this purpose. In effect, USX and other employers are paying administrative costs via three forms: (1) through FUTA, (2) through supplemental payroll taxes, and (3) through inflated state UC tax rates because longer durations of weekly benefits are being paid to claimants.

This situation is particularly frustrating for employers given that the total balance of the ESAA, EUCA, and FUA subaccounts of the FUTA Trust Fund Account at the end of fiscal year 1997 was over $19 billion. These FUTA funds are primarily being used to offset general spending by Congress. This inappropriate collection and use of FUTA funds will be corrected by H.R. 3684. This bill is a historical step to end the counter-productive over-collection of more than $2 billion a year in FUTA taxes. The bill will assign the responsibility for the collection and reporting of FUTA tax to the states. Our company believes that by giving states this responsibility and additional administrative financing, the states will have the incentive to increase the efficiency of their UC programs, without decreasing current claimant rights and privileges. Our company also believes that in the long run, all employers will see paperwork burdens reduced and, eventually, state UC tax rates for employers will be reduced without sacrificing the UC program's efficiency or benefits for jobless workers.

<u>USX supports H.R. 3684 for the following primary reasons:</u>

1. <u>Sufficient Funding for Administration of State UC Program.</u>
The underfunding of state UC administration costs by Congress has resulted in significant increases in costs for employers. When state administrative agencies lack the resources to provide reemployment services to UC claimants, they tend to concentrate on processing weekly UC checks on a timely basis. The state UC agencies are then forced to reduce their efforts in enforcing the work search and eligibility review requirements. As a result, claimants are taking longer to find new jobs which, in turn, means that the duration of collecting UC benefits has been extended. Despite the current historically low unemployment rate of 4.3% and job openings going unfilled, the average duration of UC claims is actually increasing relative to previous periods of low unemployment.

H.R. 3684 will overcome these obstacles by providing each state with the ability to cover administrative costs at a 100% level. This should alleviate the current situation and allow state UC agencies to process jobless claims in an efficient and timely manner and also enable each agency to give significant oversight to such matters as recovery of fraudulent payments.

2. The FUTA surtax of 0.2% will be repealed after year 2003.
Part of the $19 billion balance currently in the Federal Trust Fund Accounts is attributable to the "temporary surtax" of 0.2%. This surtax, which was enacted by Congress in 1976 and raised the FUTA tax rate to 6.2%, has generated approximately $1.5 billion a year since enactment. The temporary surtax was needed to pay for a deficit in the Federal Trust funds which resulted from Congress creating a temporary supplemental UC benefit program in 1976 for unemployed individuals who had exhausted their 26 weeks of regular state UC benefits and 13 weeks of extended benefits. USX and other employers did not oppose the surtax when it was first enacted in 1976, recognizing that the funds were needed to pay for the temporary extended benefits payable under the 1976 program, with the understanding from Congress that the surtax would expire once the debt was repaid. Even though the surtax debt obligation was fully retired in 1987, Congress has never repealed the "temporary" 0.2% surtax. Four times since 1987, Congress extended the surtax, including last year when the surtax was extended until 2007 as part of the balanced budget agreement.

USX currently pays a surtax of $.5 million each year. Just to pay for this temporary surtax obligation, USX Corporation must sell about 7,100 tons of steel products and 100,000 barrel equivalents of refined oil products. Under H.R. 3684, this surtax will be repealed after 2003.

3. Elimination of state supplemental taxes.
As was stated earlier, various states are using more than $200 million of their own funds -- much of it raised through add-on payroll taxes on employers -- to offset the shortfall of funding FUTA administrative costs by Congress. These taxes have caused the total tax burden to increase for USX and other employers. USX corporation advocates that the state UC program be funded responsibly at a level no less than needed for sound operation of the program. UC taxes should be no **higher** than needed to achieve the objectives of the program but not be underfunded as is the current situation. This funding problem encourages state legislators to come up with creative measures to supplement the UC program by establishing supplemental add-on payroll taxes.

Under H.R. 3684, this funding problem should disappear as the state UC system will have access to sufficient funding to deliver services and maintain program integrity.

4. Promotes lower state UC spending and taxes.
The current situation of how administrative costs are funded begs for reform. FUTA taxes are being returned to state agencies at less than sixty cents on the dollar, while the remainder of the FUTA taxes paid are being used for Congressional general spending.

Under H.R. 3684, the state UC agencies will become the tax collector and overseer of how the employer's FUTA tax is used. USX believes that the transfer from Federal to state responsibility for FUTA tax collections and reporting will be

a good step forward for employers as there will be greater accuracy in the collection and appropriation process. Also, states will be more motivated because they will have the ability to appropriate the necessary funding to finance all operating costs and more easily monitor individuals who try to defraud the UC system. Under the legislation, FUTA revenue paid by employers would be placed in an administrative account for each state and the appropriation of the administrative funds from that account would be the responsibility of each state legislature. The accountability for the use of the funds will be enhanced by requiring each state UC agency to issue an annual status report to their governor, legislature and the public as to services provided to claimants and how the administrative monies were spent.

In addition, a "hold harmless" Supplemental State Employment Security Account will be set up by extracting 2% from the FUTA collections each year that will be used to supplement FUTA collections in smaller states that do not have a sufficient employer base to cover 100% of their administrative expenses.

Likewise, a Secretary Employment Security Administrative Account will be set up again by taking 2% from each year's FUTA collections to finance the remaining UC operations of the Department of Labor such as program integrity and conformity/compliance matters.

USX is also in support of the provision in the bill that mandates that excess funds from a state's administration trust account at the end of each annual fiscal period will automatically flow into the state's benefits account. This should enable state legislators to consider reducing state UC tax rates as well as eliminate add-on payroll taxes for employers.

H.R. 3684 will still require a federal/state partnership but the Federal partner will have a smaller role. States still will need to be in compliance with the Federal law that compels each state to have a UC program that provides unemployment claim filing and job assistance services and meets limited federal criteria. Under the bill, all benefits and legal protections for unemployed individuals will remain unchanged.

5. Eliminates duplication of collection and reporting of UC taxes.

Under the current UC system, USX must pay and report state and federal taxes to two separate collection agencies. This duplication of effort is unnecessary and will be eliminated under H.R. 3684. All employers will see tax simplification related to paperwork reduction and compliance costs. Employers will have only one agency to deal with relative to UC-related matters. This is estimated to save employers most of the $100 million a year which is currently being paid to the U.S. Treasury out of FUTA administrative funds for services rendered.

6. **Codifies quarterly payment of FUTA and state UC taxes.** USX believes that the Administration's Fiscal Year 1999 proposal to pay and report FUTA and state UC taxes monthly is nothing more than a gimmick that does not actually raise any more revenue. If the administration's proposal was enacted, the monthly collection of FUTA and state UC taxes will *triple* the reporting burden for USX and other employers without any significant advantage for taking such an action. It would also divert scarce resources that state UC agencies need for other purposes. It also represents another unfunded mandate on states.

Therefore, USX agrees with the provision in H.R. 3684 that codifies the collection by the states of FUTA and state UC taxes on a quarterly basis.

In summary, USX earnestly supports H.R. 3684 because it addresses the major problem of underfunding administrative costs for state UC programs by Congress. H.R. 3684 will create sufficient funds for state agencies to provide and deliver timely services and maintain program integrity. FUTA will be used as it was intended.

In addition, this bill will also have the following other positive effects: (1)the length of unemployment should be reduced for many claimants and that will positively impact the state UC benefit trust funds which should help to reduce employer rates; (2) states will have more flexibility in designing service delivery systems without being concerned that once a program is in operation it might have to be stopped because of inadequate funding from Washington; (3) administrative costs should be reduced and total tax collections will increase with a unified approach to both the state benefit tax and FUTA tax collections; (4) the 0.2% temporary surtax will be repealed; and (5) employers will have their collection and reporting compliance burden reduced by dealing with one UC agency. Therefore, USX asks that committee members support H.R. 3684 and have it presented to the Ways and Means Committee for consideration this year. It is definitely a win-win-win proposition for employers, unemployed individuals and state UC agencies.

USX Corporation has received no Federal grants or government contracts related to the issue of Federal Unemployment Compensation taxes during the last two fiscal years.

I thank you for your kind attention.

Respectfully submitted,

William Petz, Jr.
USX Corporation
USX Tax Division

Chairman SHAW. Thank you.
Mr. Davidson.

STATEMENT OF JOHN P. DAVIDSON, STAFF ATTORNEY, CHRYSLER CORPORATION, AUBURN HILLS, MI

Mr. DAVIDSON. Thank you, Mr. Chairman, Mr. Levin. I appreciate the invitation to address you this afternoon on H.R. 3684.

As an opening comment, I want to say that Chrysler strongly supports an efficiently run employment security system throughout the country. While supporting this system, we also recognize the need for individuality among the States, as they all have their special circumstances to be addressed.

The FUTA tax which is the subject of H.R. 3684 is the issue being addressed here today. This tax is dedicated to financing the administration of the employment security system and creates a reserve for the payment of Federal share of extended benefits. Employers pay approximately $6 billion a year in FUTA taxes.

Throughout the years I have seen many State employment security agencies struggle to deliver the services because they do not have the funds avot have the funds available. Being one of the large customers of the State agencies, we are concerned about these reductions. The reduced funding has left the State's with the following alternatives: One, supplement the administrative funds for their State general revenues; two, assess a special State tax solely for the supplementation of the available funds; or three, cut services by closing branch offices or diverting available resources to other functions.

States should not be confronted with such choices. The funds are there, but are being diverted to other purposes not intended by FUTA.

Employers and workers rely on the services of the Employment Security Agencies. We have instructed our plants to use the employment service exclusively to obtain workers. We also rely on the unemployment insurance agencies to pay benefits in a timely and accurate manner to eligible employees. It is troubling that our employees are unable to receive the services while employers continue to provide adequate revenue through the FUTA taxes.

Perhaps the greatest concern is the loss of program integrity. Based on USDOL quality reports, error rates of 10–15 percent are not unusual. In 1997, nearly $20 billion were paid in unemployment benefits. That means, assuming a 10 percent error rate, nearly $200 million were paid incorrectly. That is money employers have paid and entrusted to the States to properly administer. Unfortunately, most of the money paid in error is never recovered and the trust funds and the employers suffer from that loss.

The biggest change which has taken place under the guise of efficiency is the use of automated systems for applying and certifying for benefits. While this is good administratively, it adds to the decline in program integrity. Let me illustrate with a couple of scenarios that we have encountered.

When States started allowing claims by mail, we actually had a former employee certifying for and receiving benefits while he was in prison. Another situation that we have caught where improper benefits were paid is when a person is hospitalized. With phone

certification, the individual can call from his hospital bed. How can these claims be caught?

Don't misunderstand, I am not advocating returning to the old days when people were lined up around the block waiting up to six hours to be serviced. Instead, I'm advocating more funds for the audit and the police functions at the State agencies. Improper benefits are a direct cost to employers since they are charged to the State's experience rated trust funds.

How does this address the need for H.R. 3684? Where States have adequate funding to administer the program, they can staff the agencies to improve the integrity and the services provided. The squeeze caused by the reduction in funding has forced States to seek approximately $200 million per year from other sources, notwithstanding the fact that, there is $2 billion in surplus FUTA being collected.

The main feature of H.R. 3684 is the establishment of the State specific accounts for the deposit of FUTA revenues. It will be up to the State legislatures to appropriate the funds needed for proper administration of their system. The funds will still be held by the U.S. Treasury, as are the benefit trust funds.

The second feature is the collection of the FUTA by the States. This would eliminate the need for the employers to file two tax returns each quarter. It would also eliminate the collection expense currently charged by IRS while increasing the integrity of the tax collection.

And then, there is the notorious two-tenths temporary tax. This amounts to an unnecessary $1.5 billion per year of employer payroll taxes. The purpose of this tax was to repay a loan for emergency benefits in the mid-1970's. This loan was repaid in 1987. There is no need for that tax to be continued at this time, much less, to the year 2007. H.R. 3684 will repeal this tax in 2004.

I'm not going to lengthen this testimony discussing the rest of the bill—others will be doing that. I'm here to say that we support this bill and hope the committee and other members of Congress will support its passage.

Mr. Chairman, thank you for your attention.

[The prepared statement follows:]

TESTIMONY OF
JOHN P. DAVIDSON
CHRYSLER CORPORATION

H.R. 3684
UNEMPLOYMENT INSURANCE
ADMINISTRATIVE FINANCING REFORM

HOUSE WAYS & MEANS HUMAN RESOURCES
SUBCOMMITTEE HEARING
JUNE 23, 1998

Good afternoon. My name is John Davidson. I am an attorney with Chrysler Corporation and responsible, among other things, for the Unemployment Insurance program for the Corporation. I have been involved in Unemployment Insurance for most of my 29 years with Chrysler Corporation. I am also on the Board of Directors of "UWC, Inc., Strategic Services on Unemployment and Workers' Compensation" (hereinafter, UWC) and am active in various state employer organizations dealing with unemployment insurance matters..

I thank you for the invitation to address this Subcommittee this afternoon about the Administrative Financing Reform proposal for the Unemployment Insurance system in this country, being H.R. 3684. I have been actively involved in the preparation of this proposal through UWC. I am here to speak in support of this bill.

As an opening comment, I want to stress that our Company strongly supports an efficiently run employment security system throughout this country. While supporting this system, we also recognize the need for individuality among the states as they all have their special circumstances to be addressed.

PRESENT SYSTEM FUNDING

The unemployment insurance system in this country is financed by two payroll taxes paid by all employers. First is the State Unemployment Tax which is dedicated exclusively for the payment of unemployment insurance benefits. These funds cannot be used for any other purpose. This is an experience rated tax where the employers with the highest amount of unemployment pay more than those employers having little or no unemployment. This tax currently generates approximately $24 Billion per year.

The second tax is the payroll tax paid under the Federal Unemployment Tax Act (FUTA). This tax is dedicated to financing the administration of state employment security systems and creating a reserve for the payment of the federal share of Extended Benefits. A portion of this tax is also being accumulated in a loan account to assist those states whose trust funds become insolvent. Currently, there are no outstanding loans, so this account continues to grow. Employers are paying approximately $6 Billion per year in FUTA taxes. It is this tax (FUTA) that is the subject of H.R. 3684.

SERVICE REDUCTIONS

Throughout the years I have seen many state employment security agencies struggle to deliver important services to their customers (employers and workers). The problem exists because they do not have the funds available to adequately deliver these required services. Being one of the large customers of the state agencies, these reductions in service have been a matter of great concern.

In the mid-1980's, I was part of a team that visited with Michigan's Congressional Delegation to encourage additional funding for the Michigan's Employment Security Commission. This team consisted of employers, representatives from organized labor, state legislators and the Michigan Economic Alliance. Michigan was then faced with closing branch offices and curtailing employment services at a time when unemployment rates were high and people needed all the help they could get to return to work. The only concern that could be addressed with the available funds was the timely issuance of unemployment insurance benefits checks. Subsequently, the Contingent Fund was included in the annual budget.

The Contingent Fund was intended to supplement the appropriation which had been given to the states when the unemployment activity was greater than planned. Unfortunately, that has not worked as well as hoped. Because of the existance of the Contingent Fund, the basic funding has been continuously reduced. While the costs to state employment security agencies for wages and benefit, as well as the "fixed" costs (i.e., rent and utilities) continue to rise, the dollars appropriated to the states are being cut. This only exacerbates the problems to the states.

Over the years, the reduced funding has left the states with the following alternatives.

1. Supplement the administrative funds through state general revenue grants. This reduces the state funds needed for other programs.
2. Assess a special state tax solely for the purpose of supplementing the administrative grants received from the federal government. This increases the taxes on employers and, possibly workers, and results in paying for the same service twice.
3. Cut the valuable services provided by the state employment security agencies by closing branch offices or diverting available manpower and resources to other functions.

Some states may have been forced to do more than one of the above, which drastically reduces the benefits and services of the employment security program.

States should not have to confront such choices. The administration of the employment security programs was designed to be financed by the tax dollars employers pay under the FUTA. The funds are there, but are being diverted for purposes other than those for which the FUTA tax was intended.

Employers and workers all rely on the services of the Employment Security Agencies. Chrysler Corporation has instructed all our plants to use the employment service exclusively to obtain employees. We also rely on the unemployment insurance agency to pay benefits in a timely and accurate manner to those employees who are unemployed through no fault of their own. It is troubling that our employees are unable to receive needed services at the time of their unemployment, regardless of how short it may be, while we continue to provide adequate revenue to provide the needed services through our FUTA taxes.

PROGRAM INTEGRITY

Perhaps of greatest concern is that the integrity of the program is suffering. Each year the USDOL publishes a quality report showing how the state agencies perform. An error rate of 10% to 15% is not unusual. In 1997, the total unemployment benefit payments amounted to nearly $20 Billion. That means nearly $200 Million in benefits were paid incorrectly, assuming an average error rate of 10%. That is money employers have paid in state unemployment taxes and entrusted to the employment security system to properly administer. Unfortunately, most of the money paid in error is never recovered and the trust funds, and employers, suffer from that loss.

The biggest change which has taken place under the guise of efficiency is the use of automated systems to apply for unemployment benefits and continue to certify eligibility for benefits. I can agree these systems are faster and less costly to administer. But what verification is there that the individuals claiming benefits are truly entitled to them? How does anyone know if the claimant is truly an unemployed individual? Some states allow a benefit year to be established even while the individual is working thereby preserving those wage credits. What's to stop that individual from

certifying for and receiving benefits? The states presently don't have the resources needed to adequately monitor the benefits being paid and must rely on other sources to police benefit payments. That burden usually falls on employers, again shifting the administrative responsibility and cost away from the agencies charged with that responsibility.

Let me illustrate a few scenarios we encountered where program integrity has failed. When states started allowing certifications by mail, we actually had a former employee certifying for and receiving benefits while he was in prison! With the telephone certification, this same person could have someone else call in and certify for him, and no one would be the wiser. How about the person who takes a vacation and has a relative call in for him? Who knows unless he says something to the wrong person. Another situation where we have caught improper benefits being claimed is when a person is hospitalized. With phone certification, the individual can call from his hospital bed. How can that claim be caught? When there was in-person reporting, the hospitalized individual could not certify because he/she could not get to the branch office. If the person was not hospitalized but was still unable to work, the agency could tell, visually, the person was unable to work, especially when they would walk into the branch office with their leg in a cast. With automated certification for benefits, how do we know the person is not stopping on their lunch break from that new job they have found with no help from the agency, or calling from their cellphone while working, to certify for benefits still chargeable to the prior employer? With in-person reporting, that individual had to be away from work to certify. Many times individuals would pull into the agency parking lot in a company truck and would be caught there. That won't happen with the automated certifications. Again, this is only a small illustration of a few of the scenarios we have encountered since the services have been depersonalized.

Don't misunderstand. I am not advocating returning to the old days when people were lined up around the block and waiting up to six hours to be serviced. That's what happened in the 1980's when the cuts in administrative funding began. Instead I am advocating more funds to audit and police the payment of benefits. Again, the payment of improper benefits to those individuals not entitled thereto, is a direct cost to employers as the benefit payments are charged to the state's experience rated trust funds.

All states require the person claiming benefits to be able, available and seeking work to be eligible. In fact, that is one of the federal requirements for the state laws to be in conformity. Unfortunately, with the constant cuts in funding over the years, and the diverting of available FUTA funds, the efforts to help unemployed individuals find work have been curtailed. So have the efforts to make sure individuals are seeking work as they should. This only increases the length of time people are unemployed and drawing unemployment insurance benefits which further increase the cost to employers. An average of one week of benefits with the current low level of unemployment still cost the benefit trust funds approximately $1.5 Billion. It would be much higher in times of high unemployment. Given adequate administrative funds, the states could do more to help these individuals return to work quicker and become productive citizens again.

H. R. 3684

How does all of this address the need for H.R. 3684? Where states have adequate funding to properly administer their programs, they can staff their agency to permit the required improvement in the integrity of the program and services to their customers. We are fortunate that unemployment rates currently are at an all time low.

Unfortunately, the employment security agencies are still in business and need operating capital. Many expenses do not go away just because the unemployment rate is low. Further, states have to be prepared for the dips in the economy we know will come.

The squeeze caused by the reduction in the allocation of administrative funds from the federal government has forced states to seek other resources. States have been seeking approximately $200 Million per year from their own general revenues or other sources, notwithstanding the fact there is almost $2 Billion in surplus FUTA revenues being collected annually. States look to employers to make up differences through additional payroll taxes. We don't believe this is appropriate since we are already paying too much in FUTA taxes. Why should we when we are already paying for the system? Employers want the state agencies to have adequate funds from the money we are paying

today. Like anyone else, we also want to see a reduction in our tax costs. We believe H.R. 3684 will help on both counts.

The main feature of H. R. 3684 is the establishment of state specific accounts for deposit of FUTA revenues. The state legislatures know their needs and problems. It will be up to them to appropriate the needed funds for proper administratin of the employment security program. We believe that is the best place to control the spending. With adequate funding, the states can improve the integrity and service of their programs and help to reduce costs further. It would also be easier for employers to monitor what is happening to the tax dollars they pay. The funds would continue to be held by the U. S. Treasury as are the state benefit trust funds.

A second feature of H.R. 3684 that we support is the collection of the FUTA taxes by the states. This would eliminate the need to file two separate returns each quarter (FUTA and State) as it could be done on one form. The result would be reduced cost to employers in preparing and filing multiple returns. It would also eliminate the collection expense currently charged by IRS while increasing the integrity of the tax collection. This is a win-win situation with a lower cost for tax collection, reduce the paper to be processed and improved program integrity.

And then there is the notorious 0.2% "temporary" surtax that we hear so much about. This amounts to an unnecessary $1.5 Billion per year of employer payroll taxes. The purpose of this tax was to repay a loan from general revenues for emergency unemployment benefits paid to claimants in the mid-1970's. This tax was initially scheduled to sunset after that loan was repaid. The loan was repaid in full in 1987. There is no need for that tax to be continued at this time, much less through the year 2007. It should have been eliminated in 1987, as promised by the Congress in 1976. I'm not going to put blame anywhere. Suffice it to say, employers can use that money to help create jobs for our people. This is a better use of this money than sitting in an account in Washington. H. R. 3684 would repeal this tax in 2004. We definitely support the termination of this "temporary" tax.

I am not going to lengthen this testimony by discussing all of the other provisions of H.R. 3684. Enough people will be doing that. I am here to say that we support this bill and hope this committee and the other members of Congress will support its passage.

I thank you for your attention this afternoon.

Respectfully submitted,

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[fhr3684t]

Chairman SHAW. Thank you, Mr. Davidson. I'd like to make one correction in your testimony. I hate to do it, but the math was incorrect. Ten percent of 20 billion is 2 billion, not 200 million.

Mr. DAVIDSON. I'll accept that correction. [Laughter.]

I'll just add, I think that just highlights the problem further.

Chairman SHAW. Mr. Baldwin.

STATEMENT OF MARC BALDWIN, ASSISTANT DIRECTOR, AFL–CIO PUBLIC POLICY DEPARTMENT

Mr. BALDWIN. Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to present our views this evening. I've submitted a statement for the record, so I'll briefly review the key issues in that.

Our UI system is a program of roughly thirds. About one-third of the unemployed receive benefits, one-third of their last wages are replaced, and one-third of those who enter the system exhaust their benefits before finding a new job. The record of State programs fall short of the goals of the UI system in the new economy.

The road to a one-third system is not travelled because governors or State agency's want to restrict access or because State agency's are poor administrators. The one-third system emerges precisely because of the decentralized structure of the benefit side of the program which devolution advocates mistakenly would expand. Because States face competitive pressures from their neighbors, they have strong incentives to limit benefits in the name of business climate. Whatever we may think of the ultimate effectiveness of this economic development model, the fact that benefit recipiency rates have fallen from 75 to 35 percent over the last 20 years is directly related to interstate competition in this downward pressure.

H.R. 3684 and the other devolution proposals would subject additional elements of the UI program to this pressure, limiting the national effectiveness of the program. Instead of following established social insurance principles, like pooled risk and a broad revenue base, devolution proposals force individual States to rely almost entirely on their own funding bases.

This isolation combined with interstate competition provides an incentive to underinvest in the Nation's re-employment system, promoting privatization and shifting funds from administration to benefits. Clearly, by maintaining FUTA funds in the unified budget, the current system also contains incentives that encourage underinvestment, in this case, in pursuit of a balanced Federal budget.

But devolution cures this structural problem by creating more severe structural problems. The concern about Federal trust funds being unreal or not fiduciarily sound, as was mentioned this morning, to me, is only heightened by a proposal to create 50 such State-based funds. H.R. 3684 dismantles the current system of pooled risk and reduces funding by one-fourth, putting State programs in jeopardy during recessions.

In an attempt to rebuild the current broad-sharing of risk, the proposal suggests two small funds—a revolving loan fund and a small State fund. Our written testimony details the administrative difficulties with these inadequate attempts to rebuild risk-pooling which the proposal dismantles. More broadly, this dramatic struc-

tural change runs counter to all insurance principles—pooling of risk, fair distribution, and a broadest possible funding base.

H.R. 3697 introduced by Congressman Levin and English of this subcommittee propose reform which is in keeping with these fundamental principles. It provides incentives funds for States which choose to address administrative problems facing temporary and contingent workers. It provides an increase in administrative funds generally. It establishes a solvency measure linked, again, to incentive funds and it creates an extended benefit trigger which will work, unlike the current measure which has resulted in Congressional emergency action when the EB system failed to trigger on despite high unemployment.

These reforms are overdue. They have bipartisan support and they should be passed as a first step toward longer term solutions.

Although we see the devolution proposals as a dangerous rejection of the principles which should govern insurance programs, we are also aware of the perils caused by the current situation. Both the administration of the program and the benefits side of the program are in need of reform. On administration, the devolution proposal seeks to address the level of funding to States by altering both the level and the distribution of funding. A dialogue should promote solutions which combine the best outcomes both for levels and for distribution on the following lines:

Administrative funding to be expanded while maintaining national risk-pooling and Federal stakeholder commitments. The distribution of funding among the States should more accurately reflect the cost of an effective system in each State and actual State expenditures. And finally, the countercyclical impact of the system should be improved through extended benefit reform and solvency measures.

H.R. 3697 and H.R. 3684 should provoke a broad debate about stable financing for a system which meets the three goals of unemployment insurance as outlined in our testimony. Reforms based on devolution only highlight inequities among the States and reject sound principles for organizing social insurance. Instead, we look forward to a dialogue around expanded funding and improved formula for distributing funds on the basis of need and countercyclical reforms.

Thank you.

[The prepared statement follows:]

#98-12

Testimony of Marc Baldwin
Assistant Director, AFL-CIO Public Policy Department
before the
Committee on Ways and Means
Subcommittee on Human Resources
US House of Representatives
"Employment Security Financing"

June 23, 1998

This testimony has four parts: a statement about the goals of unemployment insurance (UI) system, a critique of devolution as an approach and HR 3684 as an example, support for English-Levin (HR 3697) as a down-payment on consensus reform, and a look to the future for a bi-partisan commitment to improve financing without jeopardizing essential principles of social insurance.

The National Commitment to Unemployment Insurance

We need to be clear about the full extent of the problems facing unemployment insurance in order to identify sufficient solutions. In the UI context, the problem is much broader than financing. The problem is both financing and the programs that states are running.

Justification for improved funding rests on the three functions of the UI system: reducing the hardship of job loss for individuals, improving the counter-cyclical capacity of the economy, and, more recently, serving as the gateway to re-employment programs. These functions all require at least one system outcome: people receiving benefits. Particularly as states develop one-stop re-employment models, the link between benefit receipt and re-employment services, through profiling and through application of "suitable work" and work search requirements, becomes a central labor market issue.

Reducing income loss during unemployment and providing counter-cyclical capacity were the two motivations for creating unemployment insurance in 1935.[1] The record of state programs since then is checkered at best. Effective personal support and macroeconomic intervention rest on two related elements of the program: wage replacement rates and the percentage of the unemployed receiving benefits. On both counts, state programs have been

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[1] William Haber and Merrill Murray (1966), Unemployment Insurance in the American Economy. Homewood, IL: Richard D. Irwin, Inc.

failing, particularly in recent years.

The percentage of the unemployed receiving benefits has the most significant impact on counter-cyclical effectiveness. Between 1975 and last year, the percentage of the unemployed receiving benefits fell from 75 percent to 35 percent. Numerous studies have discussed the sources of decline.[2] State laws have not sufficiently responded to increasing women's labor force participation, the increase in part-time and contingent work, or declining wage levels.[3]

States exclude the unemployed from benefits through increasingly stringent disqualifications. Instead of "denial periods", limiting the number of weeks for which individuals can receive benefits, states have shifted heavily toward "durational disqualifications", which eliminate benefit eligibility during an unemployed period. After a durational disqualification, claimants face re-qualification requirements based on earnings from their new job. States have increased these re-qualification requirements. And, at the behest of a narrow segment of the employer community, some states are implementing laws which require an individual to re-apply with a temporary help agency when they lose a job which they found through that agency. This two-tiered system, locking some individuals onto a separate labor market track, exists in 11 states.[4] Individuals subject to this tracking have a strong disincentive to apply for benefits if they seek to better themselves through full-time employment that is more suitable.

Wage replacement rates are another element of the counter-cyclical effectiveness of the program. State programs have never replaced, on average, even 50 percent of lost wages. Throughout the 1990s, state programs replaced less than 37 percent of average weekly wages. Wage replacement rates plummeted by 10 percentage points between 1945 and 1955, from 42 percent to 32 percent. After climbing slowly, the wage replacement rate peaked at 38 percent in 1982. In the most recent year available (1997), the ratio of average weekly wages to average weekly benefits was just 34 percent, the lowest wage replacement rate since 1969.[5]

On the third goal of UI — providing income support during difficult employment transitions — we shouldn't assume that a booming economy is fixing all labor market problems.

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[2] Daniel McMurrer and Amy Chasanov, "Trends in unemployment insurance benefits." Monthly Labor Review, September 1995.

[3] Amy Chasanov, "Clarifying Nonmonetary Eligibility Conditions in the Unemployment Insurance System," University of Michigan Journal of Law Reform, Special Issue, 1995.

[4] Three states added these provisions last year. Diane Runner, "Changes in state unemployment insurance legislation in 1997," Monthly Labor Review, January 1998.

[5] US Department of Labor, Unemployment Insurance Service, Division of Fiscal and Actuarial Services.

The most recent displaced worker survey by the Bureau of Labor Statistics shows continued economic difficulties for individuals who suffer permanent job loss. More than half of all displaced workers in industries outside finance, insurance, and real estate suffered income losses if they found new employment. More than 20 percent of all operators, fabricators, and laborers were still unemployed in February 1996 after losing a job during the three year period from 1993 to 1995.[6]

Increased funding for re-employment services is a key step to improving these numbers, but UI eligibility is essential. Unless unemployed workers are eligible for UI, too few of them will be linked to these services through the UI system. The UI system provides more than income support. It is also intended to improve labor market performance by defining "suitable" work, enforcing work tests, profiling workers for appropriate services, and defining "able and available" workers. These labor market functions are subverted when individuals are excluded from the UI portion of the system.

State behaviors which limit access to benefits and to re-employment systems are cause for national concern. As the United States competes in an increasingly international economy, state decisions bear directly on national performance. In 1935, the Social Security Act established a national administrative finance system precisely with this system integrity in mind. A uniform national tax, federal oversight, and a refund to states which operate systems which conform to national standards were established specifically to ensure the existence and function of the administrative system.

In contrast to the uniform federal tax for administration, taxes on the benefit side of the program are subject to state regulation. Thus, the incentive to limit outlays through reduced benefits and restricted eligibility is clear. By holding down benefit outlays, states can reduce employer taxes in an effort to appeal to "competitiveness" claims. Downward pressure through interstate competition would suggest that states would limit payments to the unemployed, lower wage replacement rates, and impose tougher penalties -- all of which characterize current state behavior. By expanding the range of program measures which are subject to interstate competition, devolution proposals add fuel to the "race to the bottom" which characterizes the benefit side of the program.

State behavior around taxation for benefits is a relevant indicator of what may occur under devolution. In the early 1980s recession, 33 states had insufficient forward-funding of their benefits systems and had to borrow from the federal government. Trust fund balances have never fully recovered from this shock, despite years of sustained economic growth, largely because of downward pressure on the revenue side. The high cost multiple (HCM) is a straightforward measure of trust fund balances relative to potential outlays. An HCM of 1.0, for

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[6] Steven Hipple, "Worker displacement in an expanding economy," Monthly Labor Review, December 1997.

example, means that a state has sufficient reserves to provide benefits during a recession as costly as the preceding worst 12-month period. Before the 1975 recession, the national HCM was almost 1.2. Now, the national figure is just over .6. Despite some particularly low high cost multiples, 16 states proposed tax rebates around unemployment insurance last year.[7] New York and Illinois have proposed tax giveaways despite being among the five least solvent states in the country (.31 HTM and .5, respectively). Proposals to expand state authority through devolution must be viewed in this context.

The significance of these patterns is **not** that states are waging a conscious attack on unemployed workers. The issue is the structure of the system and the incentives which are built into a devolved system, primarily the downward pressure exerted by interstate competition. Social insurance principles suggest it is important to reduce, not expand, the program elements which are subject to those pressures. The track record of state programs suggests that these fears are not abstract, but bear on most aspects of state programs. The primary reasons to administer the system — counter-cyclical impact, personal insurance, and a re-employment gateway — are contradicted by state behavior under interstate competition.

Current Administrative System Based on Fundamental Social Insurance Principles

The US has the only unemployment insurance system in the world without national standards for eligibility, disqualifications, intensity of sanctions, benefit levels including family allowances, benefit durations, employer tax rates, and most administrative procedures. In the context of this overwhelming power granted to states, worker advocates are justifiably skeptical about appeals for further devolution of authority. If the US has a significant structural problem with its system, the problem is not just the national government's role in administration. The problem is also an over reliance on states to control all elements of the program which directly affect the living standards of unemployed workers: eligibility, benefit levels, and durations. Only in the United States can two similarly-situated workers living in different states be treated so differently under UI.

The minor but important functions reserved for the federal partner were dealt a critical blow even during the drafting of the Social Security Act. A uniform national tax was proposed and passed for administration. But the uniform national tax was paired with an experience rated tax for benefits, following employer insistence, when the bill went to the Senate. At the time, Representative Cooper pointed out that the experience rating provision gutted the role of the federal tax in eliminating interstate competition around taxes for benefits.

Why a uniform national tax? National administrative financing was deemed fundamental

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[7] Greg Jaffe, "South Takes Aim at Jobless Insurance Tax," Wall Street Journal, January 27, 1997.

to the existence and performance of the system. The devolution proposal attempts to improve the level of state funding by virtually eliminating the risk-pooling which federal funding provides. Maintaining federal control over administrative financing is in keeping with essentials of social insurance, namely pooling of risk and redistribution of funds based on ability to pay.

This social insurance principle is not abstract. As discussed above, the over-reliance on states for so many elements of the system has already had a dramatic, negative impact on all three goals of the system: it has reduced the living standards of unemployed workers, damaged the counter-cyclical power of the system, and limited the re-employment potential of this gateway to services.

The Devolution Proposal (HR 3684) is Unworkable

Devolution is wrong in principle. The current proposal is also, we believe, unworkable. Any administrative finance program must address two central issues: the level of funding and the distribution of funding. We agree that the current system distributes too little money to the states and uses flawed measures to derive the formula for distribution. But the devolution proposals use the low level of funding to create a new system which will adversely affect both the level and the distribution of funding.

Problems include:

* **The national debate about financing cannot begin with the conclusion that one-fourth of the funding stream, the .2% tax, is unnecessary.** Employers currently pay just $56 a year per employee for unemployment insurance administration, the Employment Service, and labor market information support. The devolution proposal will save employers just $14 an employee — at a huge cost to system integrity. We fully agree that employers, workers, and state agencies deserve a greater return on FUTA funds, but disagree that revenue should be cut and the system dismantled to achieve this goal.

* **The revolving loan fund shouldn't revolve.** Recessions don't hit one state at a time. Any contingency which warrants a loan fund warrants a more serious funding level and stable fund. When this fund proves insufficient, states will come to Congress seeking general revenues. The devolution proposal, therefore, cuts employer taxes by one-fourth and expects other taxpayers to meet the cost if the loan fund proves inadequate.

* **The "council of lesser states" is particularly unworkable and it is vitally important**. The principle role of federal administrative financing is to pool risk and share expenses on the basis of ability to pay. While dismantling this social insurance function through devolution, advocates of the policy create a small state

fund in hopes of restoring some measure of shared risk. Their solution is insufficient to the task. In earlier drafts, the function of the small state council was to be performed by the Congress. Now all federal tax raising and distribution in the proposal is handled by Governors. This is a remarkable degradation of federal authority over federal funds.

The Council raises at least three significant problems. 1) Congress shouldn't give such powers to a randomly selected group of Governors. 2) It is not at all clear that they can reach consensus. More likely, some Governors will form a group to the detriment of other Governors and their unemployed workers and job seekers. 3) The right way to distribute these funds among the states would be a formula based on need and cost. But a formula for distributing funds along these lines to small states is also the right distribution method for all states.

* **The ability to shift funds between administration and benefits is a prelude to further decline of the system as identified above.** It would be bad enough for the system if state administrative financing were devolved and kept separate from the benefit side of the system. But by allowing states to move funds from administration to benefits, the following sequence becomes possible: spend too little on administration, put the money into benefits, reduce eligiblity even further, return the savings to employers. This incentive system is contrary to the national interest in expanding administrative means to promote re-employment.

* **The Extended Benefits (EB) proposal retains the worst element of current system, the inaccurate trigger mechanism.** Shifting the full burden for EB to states will increase cost to states which are generous to unemployed workers by eliminating the federal match. The right approach is the English-Levin (3697) proposal, namely, fixing the EB trigger and retaining the 50 percent match.

* **The delay in the start date for the bill avoids destroying the budget agreement in the House, but the Senate budget window is 10 years.** It is irresponsible to advance a proposal with such significant budget implications in the distant future.

* **The proposal would allow Governors to privatize programs with minimal oversight of the contracting process.** By removing the merit staffing requirement, the legislation reduces protections against waste, fraud, and abuse without suggesting alternative safeguards. The Coalition includes the National Association for Alternative Staffing, which advocates for employee leasing arrangements, and the Princeton Claims Management firm, which is part of the vast industry in the US which helps employers avoid paying UI claims. The presence of these coalition members highlights a privatization agenda and severely limits any inroads they might make among other stakeholders.

* **The proposal will effectively dismantle all federal quality control.** HR 3684 includes the sweeping statement that "states shall not be required to comply with interpretations of the Secretary of Labor with respect to methods of administration...including but not limited to requirements with respect to quality control, if such interpretations impose additional administrative burdens on the states, unless congress enacts legislation whcih approves such interpretation." Because any quality control effort can be argued to include administrative "burdens", this language effectively dismantles Department of Labor oversight of nationally important issues.

English - Levin (HR 3697) An Important Down Payment

The Levin-English bill should be a consensus down payment on reform. It provides some incentives to expand eligibility, improves the counter-cyclical capacity of the system through solvency measures, and provides increased funds to states.

* **By providing incentive grants to states which pursue alternative base period accounting methods, the legislation encourages an extremely important reform for low wage and contingent workers.** These funds are available to states which choose to implement this reform; it does not require states to take this action.

* **Modifying the Extended Benefit trigger will improve the future performance of this important element of the system.** The AFL-CIO has supported a lower unemployment trigger, but it is essential that the country move in the direction of the Levin-English bill.

* **Establishing a solvency target, in keeping with Advisory Council on Unemployment Compensation advice, is an important step toward sufficient counter-cyclical capacity.** Clearly, solvency can be reached in various ways, with different implications for unemployed workers. We nevertheless support this effort as an element of broader reform.

* **Additional funding for UI administration, as included, is overdue and badly needed.**

* **The Unemployment Insurance Dialogue process is an important intervention to raise awareness and generate new ideas.** In contrast to the devolution effort, the dialogue has the potential to generate a true consensus reform proposal for administrative finance, bringing together stakeholders from state agencies, employers, worker advocates, and the federal partner.

These modest, targeted reforms enjoy bi-partisan sponsorship and should be passed as a step toward larger reform.

Building a Consensus for Principled, Workable Reform

Administrative finance should be an area where bi-partisan reform is possible, but such reform is only possible starting from shared goals. The effort to devolve funding has raised core issues about the level of funding and the need to improve re-employment services. Now, the impetus for change should be directed in more workable directions.

Longer term options for discussion should include:

* **Increased Funding.** Devolution advocates start with the assumption that Congress is the problem. A dialogue on administrative financing must confront the reality — and desirability — of a continued Congressional role. Maintaining roles for federal partners is consistent with social insurance principles and a broad dialogue of stakeholders.

* **Distribution Formula.** Most observers agree that the formula for distributing funds among the states is based on inaccurate data and outmoded cost information. This conclusion does not suggest that devolution is the correct response. Instead, stakeholders should converge on measures that accurately reflect the cost of a sufficient system.

* **Improve Counter-Cyclical Impact.** As in the English-Levin (3697) bill, solvency targets and EB reform are important steps toward improved counter-cyclical effects. There may be others which stakeholders can agree upon.

The stakes for improving administrative finance and other aspects of the unemployment insurance system are extremely high. Because UI is increasingly a gateway to re-employment services and income support during transitions, the UI system is a core element of US human resource policy. Congress should advance a modest down payment on reform, through the English-Levin bill (HR 3697), and promote a broader dialogue leading to a consensus reform. Proposals which expand the realm of state control take the system in the wrong direction, increasing downward pressure on the system, and encouraging further degradation of the national employment and training system.

Chairman SHAW. Mr. Levin.

Mr. LEVIN. Well, it's late. I'll be brief.

I agree with you completely about the monthly. I don't think it's part of our proposal. It's a budget proposal. I don't think it will happen. I also agree about the underfunding of the administrative funding and we try to handle that. I would simply urge—you come from a very responsible corporation—that we try to proceed not kind of automatically choosing upsides here or getting caught in labels, but try to look at what the problem is.

I think one of the problems with the proposal with the majority, at this point, is that if you don't have a substantial sharing of the risk, it can affect the administrative provisions, as well as the other side of it. I think you have more employees in States with high recipient rates than low. To some extent, the administrative formula today reflects how many people the States are servicing, and I would think you would want to keep some reflection of that.

Also, you have, I think, an unusual or beyond average proportion of your employees in States that have had a very cyclical past. And, if you don't have some sharing of the risk, you're going to have some real problems. I don't think the automation is the result of the shortage of administrative fund. I think the history, for example, Michigan is something else. That went in into effect I think, when there was a much larger receipt of administrative fund. The present proposal on the employment service side in Michigan is to abolish and to do things by machine—employment placement.

So, I would hope that we can take, Mr. Chairman, a look at those administrative problems. Extended benefit program needs to be looked at. The last thing we want to do is to maintain the status quo, I would hope, which your proposal does. So, this isn't going to happen this year. We've got some time.

Chairman SHAW. Whose proposal maintains the status quo?

Mr. LEVIN. On extended benefits?

Chairman SHAW. Oh, on extended benefits.

Mr. LEVIN. I would hope that we could sit down and have a true dialogue about looking at the unemployment system in an age which is very different from when it was formed. But, I do think that reflexive shifting to the States at a time when it isn't only globalization internationally, there is globalization nationally, is something we really need to look at and I hope we can all do it together.

I don't know, Mr. Davidson, and Mr. Petz and Mr. Baldwin, you want to comment.

Mr. DAVIDSON. Mr. Chairman, if I may respond to it briefly?

Mr. Levin, I don't want my comments with regard to automation to sound like I disapprove of that. I do agree that it is a good thing to have. The concern that I had that I tried to address is that because of the automatization, the integrity of the program is suffering. And because it is suffering, it needs a tighter policing or auditing or control within the State agencies. Unfortunately, the insufficient revenues prevents them from doing that.

This is the point that I was trying to get to.

Mr. LEVIN. I would just say that I worry about the quality of the system. In fact, one of my objections to what's proposed in Michigan in terms of the abolition of the employment service is that, I

think, you're never sure who's looking for work. So, let's not argue that—discuss it.

But, I just hope all the focus isn't on the .2 percent. We've debated that off and on and our proposal continues to 2003, and I understand the resistance to it. But, let's also focus on the larger needs of tailoring an unemployment system in this age where more and more dislocation is not temporary, but permanent. And where we need to be sure where people like we reformed the welfare system, if they're going to be laid off, in more cases than was true 20 years ago, permanently, are trained and re-trained to go back to take another job.

Mr. DAVIDSON. Thank you, Mr. Chairman.

Chairman SHAW. We've brought up reforming the welfare system, and I think somewhere during this debate, I have to remind you, Mr. Levin, that all through this debate on welfare reform race to the bottom, was used over, and over, and over. Lack of confidence in the State was expressed over, and over, and over, and all of this came from your side of the aisle—a bunch of it from you.

Mr. LEVIN. No, no, no. You never heard me once say that about race to the bottom.

Chairman SHAW. I never heard you say that——

Mr. LEVIN. I never used that term.

Chairman SHAW. Well, you're the only one that didn't.

Mr. LEVIN. I never.

Chairman SHAW. But anyway, we had confidence in the States. I have confidence in the States. Frankly, the three gentlemen representing States here today, I have ultimate confidence in them and I have a total lack of confidence in the present system and the way it's being administered.

There is no question in my mind, tax on employment is the most regressive tax you can have and I'm sure all of us would agree to that—business and labor. And this is part of the compensation of the people you represent in labor unions. It's a question of this being a tax on their employment. Now the fact that the employer pays it, makes no difference. It's still a tax on employment and it's regressive.

I think it is really, really outrageous that these huge surpluses that we have built up, that don't even exist—and you talk about actuarialy sound. Nobody is going to say a program where there "ain't no money in it" is actuarialy sound. It's an IOU from the taxpayers that they're going to have to come up, cough up with the money on the future budgets, future congress's and future administrations. There's no recession out there. I know that—you know that—we all know that. There are going to be times when that so-called stealth surplus is depleted and comes down to zero, but that's just simply a book entry because it's going to be taxed against the taxpayers of the day of the recession. We know that.

There is no surplus. It is a fraud. It is a total fraud and I think the quicker we face up to that, and I think the .2 percent is a very, very valid issue. A temporary tax is a temporary tax. And it should become a permanent tax. And to make things even worse, it's kept as a permanent tax in order to make it look like we're balancing the budget.

I do have one question that I'd like to ask you, Mr. Baldwin. As I read your testimony, on page 2, you discuss various ways that States have narrowed eligibility for benefits which you oppose, and I can understand that. Later on page 6, you argue that more extended benefits should be provided, half of which would come from State taxes through the use of a more generous trigger mechanism. Then, on page 7, you talk about how States should use alternative base periods allowing more individuals to qualify for unemployment benefits.

Following through on your position on this proposal would result in more unemployment benefits being paid out. I totally understand that. Yet, later on page seven, you talk about the importance of establishing and reaching a solvency target that is, by building up larger reserves in State benefits accounts to meet needs of a recession. Now how do you reconcile these competing goals? And wouldn't it require huge State benefit tax increases to both provide more regular and extended benefits, and ensure that sufficient funds are built-up for their future needs?

Mr. BALDWIN. Well, clearly, it might. The extended benefit piece would be in the future. So, you would have funds built-up between now and then to cover that. That's paid for in the Levin-English proposal.

The administrative side of the alternative base period change is covered by the Levin-English. That covers about 6–8 percent of the unemployed. But it has a smaller price tag because they are not average employees. They're virtually, by definition, low wage employees. So, their impact on the budget is actually smaller than that.

In your own State, the State estimate was extremely low. I'm actually quoted in the Wall Street Journal questioning whether it's high enough. So, I'm acknowledging that these things will cost some money. But I believe we have a national commitment to the unemployment insurance system, not just the administrative side, but the benefits side. It's vital to the countercyclical capacity of the economy. It's vital to the income support for individuals who lose their jobs and increasingly, it is the gateway to re-employment services.

It's no accident, in my mind, that the percentage of the unemployed receiving benefits and the durations are moving in opposition directions. Fewer people are getting benefits and durations are climbing. Most people would say that benefit receipt would climb and durations would climb together because they have this image that people sit around. On the contrary, people get into the UI system and that is their gateway to re-employment services. So, I actually think that the cost will be lower than a lot of folks would estimate.

Chairman SHAW. Mr. Baldwin, I recall vividly, the hearing that we had on this when we were extending the benefits. At that time, Mr. Downey was chairman of this committee. And I don't recall whether I was a ranking Republican member or just one of the members of this committee, but from all the statistics we sought, people went back to work about the time the benefits ran out. This was clearly a trend. And to have more generous benefits would appear, or longer period-of-time benefits, particularly in good times—

I'm not talking about really tough times, I'm talking about good times—would simply make the periods of unemployment even longer.

Surely, you'll certainly—maybe without enthusiasm—but agree with me that people tend to look harder for jobs and tend to go back to work towards the end of the benefit period.

Mr. BALDWIN. That's correct. The operative question though is, will they find them. And in fact, because one-third of the unemployed actually exhaust benefits, that suggests that there must be something else going on in the system that extends their durations whether they have continued to received unemployed insurance or not.

Chairman SHAW. But do you have statistical data as to what happens to them when they fall off of the——

Mr. BALDWIN. There was a Department of Labor study on benefit exhaustees in the 1980's—yes. And, I'm not sure what the answer is, but I know that there is a known answer, at least in that setting.

Chairman SHAW. Well, we'll find out what they came up with back in the 1980's.

Mr. BALDWIN. There's another explanation for the spike right before you exhaust and that is, that you are looking for a job which replaces a higher percentage of your wages than what you're able to find. Closer to exhausting benefits, you give up and take the first job you can get. There's a lot of evidence of that in the displaced worker programs which show that most people have to change jobs based on—there may be some data in my testimony—lose up to 20 percent of their income. I think there's some numbers to that effect, in our testimony.

Chairman SHAW. Well, I think all of us should be outraged by the fact, maybe for different reasons—Mr. Baldwin, you'd be outraged by the fact that these surpluses are building up and being used to balance a budget because you feel there should be more generous benefits.

Business, on the other hand, feels that their payroll tax is being used for something for which it wasn't intended. And this is being used to balance a budget and they're being taxed unfairly.

And I think back in the middle—I think what we have to remember here and don't lose sight of the fact, that a payroll tax is part of the compensation for America's worker. The fact, at the bargaining table, if we can save those monies, save some administrative costs that you will be looking for a greater share from the corporations because it will be showing in their income statements. And you have a great deal of interest in their income statement during the time of contract negotiations.

So, I think this is one area where we can agree that we should be pushing together, and exactly where it's all going to shake out is another thing. But I think the present system that we all agree is an absolute outrage.

I want to thank all the witnesses of all the three panels that we had here today. I think we've all learned a great deal. I think that all of us are going to have to go back to the drawing boards and make some adjustment, but we do agree, and it's fine to come away from here, and even if you don't agree what road we're going to

take, that we're going to get out of this mess and we're going to start, if not in this Congress, we'll get the job finished up in the next Congress.

Thank you all very much.

This hearing is adjourned.

[Whereupon, at 5:45 p.m., the hearing was adjourned subject to the call of the Chair.]

[Submissions for the record follow:]

AFSCME

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President
William Lucy
Secretary-Treasurer

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Dominic J. Badolato
New Britain, Conn.
Henry L. Bayer
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Peter J. Benner
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W. Faye Cole
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STATEMENT FOR THE RECORD

OF THE

AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES (AFSCME)

FOR THE JUNE 23, 1998 HEARING
OF THE

SUBCOMMITTEE ON HUMAN RESOURCES OF THE HOUSE WAYS AND MEANS COMMITTEE

ON

EMPLOYMENT SECURITY FINANCING

STATEMENT OF THE
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES
(AFSCME)
FOR THE JUNE 23, 1998 HEARING OF THE
SUBCOMMITTEE ON HUMAN RESOURCES OF THE
HOUSE WAYS AND MEANS COMMITTEE
ON
EMPLOYMENT SECURITY FINANCING

The American Federation of State, County and Municipal Employees (AFSCME) submits the following statement for the hearing record on legislative proposals to reform the employment security system.

AFSCME represents 1.3 million federal, state and local government employees in addition to workers in health care institutions and the private sector. Our members include civil service employees in 19 state employment security agencies who have labored for the last 15 years to provide quality services in the face of declining resources.

Chronic underfunding of the nation's employment security system threatens its ability to respond adequately to the needs of workers and employers. The unemployment insurance program has been experiencing a growing gap between resources needed to process estimated workloads and appropriated funds. Some estimates put this gap as high as $300 million in 1998. In addition, funding for state employment service operations declined 35.5 percent between Fiscal Year 1985 and Fiscal Year 1998, even though the size of the civilian labor force grew by 20 percent. The Fiscal Year 1998 appropriation for the employment service was actually $15.6 million less than the Fiscal Year 1998 appropriation.

While the effects of this contraction of resources may not be readily apparent because of the robust economy, it is a serious concern. Funding shortages mean that the unemployment insurance program may not be able to respond effectively and efficiently to a sudden surge in unemployment. In addition, despite a strong economy, workers who lose their jobs are experiencing longer spells of unemployment than at the same point in previous economic cycles. Some of their difficulty can be attributed to a deterioration in reemployment services by employment service offices.

All of the employment security stakeholders -- business, labor, and the states -- view the current underfunding of state unemployment insurance and employment service operations with great concern. However, we do not agree with the solution proposed by some states and business organizations and embodied in H.R. 3684.

AFSCME opposes H.R. 3684 because it would:

- permit states to privatize both their state unemployment insurance and employment service operations;
- exacerbate the problem of underfunding of administrative operations; and

- alter the current federal-state employment security partnership so fundamentally that it would cause irreparable harm to this crucial economic security system.

H.R. 3684 would turn back to the states key aspects of the already limited, but crucial, federal role in the nation's employment security system: the power to influence state actions and policy by using the tax and spending power of the federal government. The legislation replaces the federal trust fund into which the federal employer tax revenue (FUTA) flows with 50 individual state administrative trust funds. While the federal FUTA tax would continue, the states, instead of the federal government, would collect and keep the federal tax revenue. Instead of Congress appropriating funds for the whole country, each state legislature would appropriate administrative funds for both the unemployment insurance and employment service offices. The plan also repeals the two-tenths percent surcharge and replaces the existing federal extended benefits program with a requirement that each state establish its own extended benefits program.

A principal assumption of H.R. 3684 is that since budgetary pressures at the federal level have caused severe underfunding of state operations, the states should have control over administrative financing. However, state performance in key areas which they already control, recipiency rates, state benefit trust fund solvency standards, and wage replacement levels, does not provide any assurance that more state control will produce a better result. Indeed, at a national average of 33 percent, recipiency rates are at an all-time low; state trust funds overall have fewer reserves for the next recession than they had before the 1995 recession when 33 states had to borrow from the federal government; and wage replacement rates currently are at the lowest rate since 1969. In all of these areas, states are subject to downward pressure which stems from interstate competition and a desire to offer a more attractive climate for business than their neighbors.

These trends are a strong indication that the states will not do any better than the federal government in fully funding the operation of the employment security system. Indeed, H.R. 3684 actually may encourage states to underfund administrative costs.

Under the bill, each state would appropriate funds from an administrative account, but any funds remaining in that account at the end of each year would have to be transferred to the state benefit trust fund. Since increased reserves in the benefit account could be used to justify a reduction in the state employer tax, state business interests would press to minimize administrative funding in order to reduce state employer taxes. Under the current system, there is a wall between the state benefit trust funds and the federal administrative account which protects the system from these pressures.

While falling short of its own objective to ensure adequate financing, H.R. 3684 also abandons the central principal of national risk pooling that is the underpinning of the current system. In defense of the 50-state trust fund structure created by H.R. 3684, its advocates argue that the states are not receiving back from the federal government as much money as their employers are paying in federal taxes.

However, the current employment security system is not intended to send back to the states an amount equal to what their employers pay. If that were the primary objective, there would be little need for any federal role at all. In fact, the current system is intended to pool revenue from all

of the nation's employers and then distribute it back to the states based on need. In doing so, the current structure allows the system to help states in recession at a time when they may not be able to come up with adequate funds.

H.R. 3684 also weakens the federal government's authority to influence state behavior in important ways. Most significantly, states no longer would have to comply with long-standing requirements for merit-based personnel to staff unemployment offices. Instead, they could hire private companies to process unemployment benefits, or employers could process unemployment benefit claims for their own employees.

The federal merit standard requirement was established in the 1930s in response to criticisms about politicization, fraud and abuse in unemployment insurance offices. At the time, fewer than half of the states had civil service systems, and the federal merit standard requirement was proposed as a way to ensure adequate accountability for these federal funds with a minimum amount of federal scrutiny or intrusion into state affairs. Without the merit standard requirement, there would be no way to ensure that states are using the revenue from the federal FUTA tax properly.

H.R. 3684 undermines or fails to address other important aspects of the employment security system. It abandons any federal role in the extended benefits program, leaving this responsibility to the states as long as their state unemployment triggers are no worse than the already inadequate federal trigger. Again, given the states' recipiency and wage replacement rates record, there is little reason to believe that most would create a better program.

Finally, H.R. 3684 achieves a long-standing objective of employers -- the repeal of a .02 percent FUTA surcharge -- even though it has virtually no policy relationship to the central purpose of the legislation. Advocating repeal of this surtax, which only costs $14 per employee per year, before considering what improvements could be made in the system wrongly makes tax reduction a higher priority than either increasing the percentage of unemployed receiving benefits or greater tax equity among employers. The level of taxation should reflect the policy needs of the system.

Overall, H.R. 3684 attempts to deal with a funding level problem with a solution that changes the distribution of funds among the states and dramatically changes the character of the existing unemployment insurance federal-state relationship. Solutions to the current administrative funding problems should be sought within the existing federal-state partnership.

We believe that H.R. 3697, which has been introduced by Representatives Sander Levin and Phil English, is a suitable downpayment on reform using the current framework. Instead of unraveling the current structure, it will help strengthen the primary functions of the employment security system: reducing economic hardship for unemployed workers, maintaining a counter-cyclical fiscal capacity to reduce the severity of economic cycles, and acting as a gateway to reemployment services for unemployed individuals.

H.R. 3697 provides an interim solution for the underfunding of unemployment insurance operations by providing for a Reed Act distribution in Fiscal Year 1999. While we think this distribution should be expanded to include employment service operations, we strongly urge favorable action on this proposal this year.

In the long run, we urge the Congress to consider the following solutions to chronic underfunding: instituting an automatic budget cap adjustment for increased administrative expenditures; reclassifying employment security administrative funds as mandatory spending; or removing the unemployment insurance trust fund from the unified federal budget. These more fundamental structural reforms would allow funding for program operations to adjust more accurately and quickly to workload fluctuations. The current disconnect between benefit expenditures, which are mandatory spending, and administrative funds, which are discretionary funds, simply does not make sense.

H.R. 3697 begins to address other important weaknesses in the unemployment insurance system. It would encourage states to increase recipiency rates, especially for low-wage and women workers, by providing incentive grants if they use the alternative base period accounting method to determine eligibility for benefits. It strengthens the countercyclical capacity of the system by improving the extended benefits trigger to make it easier for states to qualify for this program. It also would create incentives for states to improve the solvency of their state trust funds by offering them additional Reed Act funds if they make progress toward the solvency standard recommended by the Advisory Council on Unemployment Compensation.

All of these provisions of H.R. 3697 are a crucial first step to rebuilding one the nation's oldest and most important economic security programs for American workers. However, longer term reforms which address the key issues of an adequate level and distribution of administrative funding, making unemployment benefits available to more unemployed workers and at higher payment levels, and strengthening benefit trust funds so they are adequate in a recession remain important challenges.

AFSCME hopes that the dialogue initiated this year by the Administration on more comprehensive reform can create a bipartisan consensus on ways to reform the administrative financing structure and to ensure that the employment security system fosters individual economic adjustment and maintains its countercyclical capacity in the face of structural changes in our economy. We urge Congress to act now on the interim measures proposed in H.R. 3697 and to participate actively in this dialogue. Our economic security system has deteriorated substantially over the last 15 years. It is time now to focus on building and strengthening one of the nation's most successful social and economic systems.

Coalition for Employment Security Financing Reform

Testimony Submitted for the Record
Hearing on the "Employment Security Financing Act of 1998" (HR 3684)
House Ways and Means Human Resources Subcommittee
June 23, 1998

The Coalition for Employment Security Financing Reform wishes to thank the Subcommittee for considering legislation to reform financing of the employment security system. In particular, the Coalition wishes to express its gratitude to Chairman Shaw for his leadership and his outstanding work to introduce the Employment Security Financing Act of 1998 (HR 3684). HR 3684 embodies the proposals suggested by the 27 states and over 75 business organizations that make up the Coalition. The Coalition is confident that HR 3684 is the best step Congress can take to remedy the inefficiencies and inequities that scar financing of the current system. The Coalition looks forward to working closely with the Subcommittee to ensure that any legislation that is enacted is in the best interest of employers and workers.

The Federal Unemployment Tax Act came into existence over 60 years ago to guarantee financing for a national employment security system. The idea was that employers would pay the cost of administering the new unemployment compensation system along with a national job placement system to help them recruit new workers and to get laid off workers and unemployment compensation claimants into new jobs as quickly as possible. But over the years, some problems have developed. The federal government is still collecting plenty of money from employers to pay for the system, but the dollars are not flowing back to the states that operate the system.

Since the Subcommittee has already received excellent written testimony in support of HR 3684 from representatives at Chrysler and USX and from state officials in Ohio and New Hampshire (all Coalition members), the Coalition will not repeat what they have submitted. Instead, the Coalition would like to take this opportunity to provide the Subcommittee with some analysis of specific issues and copies of documents developed by the Coalition and its individual members as they have worked on reforming administrative financing of the Employment Security System over the years.

1. Sufficiency of Administrative Funds

Under HR 3684, states will be required to immediately deposit Federal Unemployment Tax Act (FUTA) receipts into their State Administration Account. The deposit of these receipts in the account held by the U.S. Treasury is required because FUTA receipts will continue to be counted as revenue in the federal unified budget. Additionally, separate accounting for each state fund is required for the change in procedures authorizing state legislatures to make appropriations.

Similar to the current Employment Security Administration Account (ESAA), the amount available to each state through its State Administration Account will be capped at forty percent of the previous year's appropriation. Annual surpluses in a state's Administrative Account will flow directly to that state's benefit Trust Fund. Any surplus in the Federal Unemployment Account (FUA) account also will be transferred to the State Administrative Accounts based upon each state's relative share of FUTA taxable wages.

States with insolvent administrative accounts may borrow administrative funds from the FUA, similar to loans currently available for states with insolvent benefit accounts.

The Coalition believes that state legislatures will have a better perspective on the state's needs than the Congress. State legislators are more immediately aware of the impact of funding levels on service delivery to their constituents and more likely to understand the need for a strong service delivery structure for employment security programs. In many instances, states legislatures are already responsible for appropriating UI administrative trust fund dollars. Furthermore, state legislatures have the mechanisms in place to respond during emergencies, and those states with biennial legislatures have mechanisms in place for managing program dollars when their legislators are not in session. In considering the advisability of granting state legislators this appropriations authority, it should be noted that a major reason for the current funding crisis is that the federal government has not lived up to its responsibilities to appropriately provide funding to the states.

Even without the additional .2% surcharge the funding provided under HR 3684 would be sufficient during a bad recession. The distribution of balances in the ESAA to the states to fund transition to the new system, the availability of interest earnings on balances in the FUA, and the growth in FUTA collection over the years will provide the revenue needed for administration. The distribution of the EUCA balance to state trust funds will provide ample funding for benefit payout during serious economic downturns. Under the proposal, state legislators could appropriate up to 140% of the amount appropriated during the prior fiscal year. This is sufficient to meet any increased administrative cost associated with an increase in claims workload. Small states dependent on funding from the Supplemental Employment Security Administration Account would be provided with the necessary funding. The 2% Supplemental set-aside would provide ample funding for these states.

2. The Real Story Behind the Funding Crisis

The real issue behind the UI administrative funding crisis is not whether in some years states get back more than they pay, it's whether they get enough in ALL years. The present funding mechanism guarantees chronic underfunding, but HR 3684 solves this problem by giving state legislatures access to more of the FUTA revenues generated from their state's employers. It also should be noted that any analysis of the percentage of FUTA dollars returned to the states is misleading if it includes supplemental benefits paid

under a temporary emergency program because these payments are not properly considered a FUTA obligation.

3. State Accountability

The Coalition believes that by renewing the State-Federal partnership through elimination of DOL micromanagement of the states that states will save money. To ensure that state programs are operating efficiently and effectively, HR 3684 builds in greater accountability by requiring outcomes reports from states. In addition, the political process of state appropriations will give business and labor a greater voice in seeing that money is spent wisely.

Under HR 3684 the Secretary of Labor continues to have broad authority in the oversight of the Employment Security System. Requirements for due process and "proper payments when due" along with authority to require reports positions the Secretary to carry out the important responsibilities of the department that ensure program integrity, nondiscrimination and the proper use of FUTA funds.

Neither the administration nor the Congress is precluded in any way from proposing and making changes or imposing requirements that will improve the program nationally or achieve an important national goal.

What HR 3684 does is prevent DOL from using funding allocations as a method to force states into changes that are part of the department's political agenda and unrelated to the day to day operations of the state program. It also prevents the Secretary from establishing federal conformity mandates upon states solely by regulation.

One of the underlying premises of the Coalition's proposal is that it is critical to preserve a national Employment Security System. The proposal does this in several ways.

The proposal preserves the core features of the unemployment insurance program, labor market information programs, and veterans employment programs. DOL continues to have the responsibility to ensure that state laws are in conformity and compliance with federal law, and would continue to certify whether states were in conformity and compliance with federal requirements. A state failing to meet federal requirements would be subject to losing the FUTA offset credit reduction for employers in the state. The proposal generally maintains DOL authority to interpret federal law. However, the proposal does provide that states would not be required to adopt methods of administration in state law as prescribed by DOL if such methods, such as quality control requirements, imposed additional burdens on the states without additional administrative funding.

The proposal would replace the United States Employment Service with the United States Employment Security Service responsible for performing the federal role related to employment security.

The primary change in the federal role relative to employment security core programs would be that the federal role relative to public employment services would become a role under which DOL would review state law and administration for specific conformity requirements under FUTA and titles III and IX of the Social Security Act rather than approving expenditures. Under the proposal, public employment services would be required to be made available to all job seekers and specifically provided to individuals claiming unemployment compensation. However, the states would be provided greater flexibility in the delivery of public employment services. The Coalition believes this actually strengthens the employment security system by providing a stronger link between public employment services and the Unemployment Insurance program.

4. Financing of Extended Benefits

The Unemployment Insurance program also includes the Extended Benefits (EB) program, which extends benefit payments beyond the regular 26-week benefit periods in states where unemployment is high. Extended Benefits are payable when a state reaches a "trigger" based on the state's level of unemployment. Benefit costs are shared equally between FUTA and state unemployment taxes. There are also special unemployment benefit programs for federal workers and recently separated military personnel.

HR 3684 requires that states maintain the EB program with the current trigger levels. However, states could choose to lower the trigger levels in their respective states as long as the federal requirements were met. The Federal Extended Unemployment Compensation Account (EUCA) balance would be distributed to the state unemployment compensation benefit accounts to provide funds to the states with which to pay for unemployment benefits. A proportional share of the balance in the EUCA account, which is projected to reach its statutory ceiling of approximately $14 billion in 1999, will be distributed to each state based upon the state's relative share of taxable wages under FUTA. The transfer of funds to state unemployment benefit accounts would be made within the Federal Unemployment Trust Fund so as not to increase outlays from the federal unified budget. The proposal also would provide that benefit eligibility with respect to state extended unemployment compensation, including work search requirements, be established under state rather than federal law.

Responsibility for administration of the extended benefits program would rest with the states, and FUTA funds would be available to the state to cover the costs of administration. The Coalition is not aware of any evidence indicating that the lack of "shared" funding for extended benefits across states as provided under HR 3684 would cause Congress to vote for more costly benefit extensions at state expense. In fact, Congress may be more reluctant to vote for extensions financed from payroll taxes when there are no federal funds involved. Furthermore, the Coalition believes that FUTA payroll taxes at any level should not pay for extensions beyond 39 weeks of regular benefits and EB, as Congress recognized by using general revenues rather than FUTA to finance the emergency supplemental benefit extension during the last recession.

5. Funding for Veteran's Programs

Services to veterans of the Armed Services are provided by Disabled Veterans' Outreach Program (DVOP) and Local Veterans' Employment Representatives (LVER) staff, who may only assist individuals who have served in the military and eligible spouses and dependents. By law, veterans also receive priority for services from the Employment Service program.

DVOP staff maximize employment opportunities primarily for disabled veterans, and help those who are about to leave military service by conducting Transition Assistance Program workshops.

LVERs provide job placement and supportive services to veterans, and ensure local office compliance with federal performance standards for veterans' services.

Veterans services provided by the Public Employment Service are all spelled out in Chapter 41 of Title 38 of the U.S. Code. HR 3684 makes no changes to Title 38. However, the Disabled Veteran Outreach Program (DVOP) and the Local Veteran Employment Representative Program (LVER) suffer the same problems as the Public Employment Service and the Unemployment Compensation Program, which are underfunding and micromanagement by the Department of Labor.

Just as the Secretary is required to fund the states for the proper and efficient operation of state unemployment laws, the Secretary is required to provide funding for state DVOP staffing "sufficient to support the appointment of one disabled veterans' outreach program specialist for each 6900 veterans of the Vietnam era and disabled veterans residing in the state" (38USC4103A(a)(I)), and funding "sufficient to support the appointment of 1600 full time local veteran' employment representatives..." (38USC4104(a)(I)).

The president's budget and the amounts appropriated by the Congress consistently underfund these requirements. According to a report by the Government Accounting Office (GAO), "Over a 10-year period, the appropriations for VETS, when adjusted for inflation, have declined by 11 percent. Moreover, since 1990, appropriations for the DVOP and LVER grants have not supported the number of positions authorized by the statutory funding formulas. States receive their DVOP and LVER grant funding from VETS through multiyear grants, and funding is estimated by figuring the amount required to support the number of statutorily determined staff positions. In allocating DVOP positions to states, the statutory formula provides one DVOP specialist for each 6,900 veterans in a state who are either Vietnam-era, post-Vietnam-era, or disabled veterans. The statutory LVER funding provides for a total of 1,600 full-time LVER staff, and allocation is primarily based on the number of LVER staff, as of January 1, 1987, in each state. When appropriations are not sufficient to support the number of positions authorized, VETS reduces each state's allocation proportionately." In FY 1997 the amount requested by the administration and appropriated by Congress funded 1446

(69%) of the 2081 DVOP positions required under Title 38. It funded 1273.5 (80%) of the LVER staff.

One of the primary purposes of HR 3684 is to increase funding available for all employment security programs including DVOPs and LVERs. Increased funding will lead to improved services for Veterans and provide dedicated Veteran staff in all public employment offices.

6. Funding for Bureau of Labor Statistics and Labor Market Information

Our nation's labor market information system provides essential information about employment and unemployment trends, jobs, and workers to a wide range of users. Most of this information is produced by SESAs in cooperation with the Bureau of Labor Statistics (BLS) and other federal agencies.

States collect, analyze, and disseminate data relating to employment, unemployment, and labor demand and supply, including monthly unemployment rates, quarterly wages, monthly estimates of total nonagricultural employment, average hourly and weekly wages, monthly estimates of the labor force, and occupational trends.

Labor market information is used by public policy makers, including the Federal Reserve, Congress and others at all levels of government, and by employers, students and counselors, job seekers, policy makers and analysts, economic developers, economists, planners and many others.

HR 3684 makes no changes in funding for BLS programs. Congress will appropriate funds from the Federal Administration Account for federal administration costs and for the Bureau of Labor Statistics programs currently funded from the ESAA. The current processes for allocating funds to states for the BLS programs will continue. Operations of labor market information activities other than Bureau of Labor Statistics programs will be funded through appropriations from the State Administration Accounts as made by each state's legislature from the State Administration Account. Since states will have access to more administrative dollars through their State Administration Accounts, the Coalition believes that states will put funding for labor market information in a better position than it is today.

7. Funding for U.S. DOL Functions

Beginning in FY 2004, the Secretary of Labor Administration Account will receive two percent of each state's annual FUTA collections. This fund will be available to Congress for appropriations for federal administration and for the Bureau of Labor Statistics programs currently funded from ESAA. This account will have a ceiling set at forty

percent of the previous year's appropriation, with surpluses returning to the State Administrative Accounts. The Coalition believes that this is sufficient funding for U.S. DOL operations of employment security programs and has seen no evidence to indicate that the 2% set-aside will provide insufficient resources.

8. Helping Employers Meet the Challenge of a Global Economy

Decentralizing Unemployment Compensation administration and employment services, which are local not national functions, will further reduce business costs and help employers compete in the global economy. Washington already gives states more control in designing their welfare programs; therefore it is logical to allow states to tailor their employment services to the unique needs of their citizens, employers, and communities. The sad irony is that the average duration of unemployment insurance claims is higher than during previous periods of low unemployment. Despite a severe labor shortage, this has occurred because states lack resources needed to move workers off unemployment rolls. HR 3684 addresses this problem and helps foster a skilled workforce by providing more resources and flexibility for administration of state employment security programs.

The Coalition's proposal would amend the Wagner Peyser Act to specify the public employment services to be provided by the states as part of federal conformity and compliance requirements under the FUTA and the Social Security Act. The Wagner Peyser Act would no longer serve as the vehicle through which states would be authorized to spend FUTA funds for employment service activity. Instead the proposal would establish the United States Employment Security Service to assist in coordinating the employment security system and exercising oversight functions. States would be required to make public employment services available to job seekers in general and specifically to provide public employment services to individuals claiming unemployment benefits. This feature of the proposal provides a stronger link between UI claimants and employment services. In addition, states would have greater flexibility in choosing the methods to be used to deliver employment services. The end result will be that employers can link up with qualified workers, workers can find jobs that fit their skills and unemployed workers can get back to work quickly.

9. Validity of Allocations Based on State "Workload"

HR 3684 would change the treatment of UI administrative funding from discretionary spending to mandatory spending as defined by the federal budget rules. Currently, discretionary funds appropriated by Congress from the ESAA for the operation of Employment Security programs are allocated to states using various formulas. The most complex and controversial is the formula for the Unemployment Insurance program.

Funds for administration of the unemployment insurance program are allocated to the states by DOL using complex and controversial formulas based on state "workload. " Workload includes items such as the number of claims processed and the number of

employer tax accounts administered. The formula also includes staff costs (average cost per position) and amount of staff time required to perform each workload item.

DOL determines the formula by first establishing a "budgeted national workload base" using assumptions about the expected level of unemployment. DOL then projects the workload for each state based on the workload the previous year and adjusting to the budgeted national workload base. The staff level required to process each state's projected workload is estimated, using the staff time per workload information. These staff-year estimates are multiplied by a designated cost per staff year to arrive at dollar funding levels. Finally, amounts are allocated for overhead.

This system has not worked fairly for a number of reasons. Congress has not appropriated enough funds to cover the total workload cost of all states, and the information in the workload formula is not current and accurate.

For many years, Congress has failed to provide enough funds to cover the total national workload. DOL has therefore revised the allocation process to reduce funding to each state across the board. For example, if the appropriation is 10 percent less than the amount needed to fund the total national workload, each state's allocation is reduced by 10 percent. Thus, every state is underfunded.

The staff effort information used in the formula has not been updated since the early 1980's. Thus, the funding formula does not recognize the shift in the cost structure of the programs which have taken place over the last two decades as states have greatly expanded their use of information technology and decreased the number of staff. Because the current allocation process is so arcane, the Coalition believes that any remnant of the current workload based system must be shelved and state legislatures should be given the discretion to determine the appropriate amount of funding.

10. Scope of HR 3684

HR 3684 is intentionally limited to dealing with one critical issue, namely administrative financing, which is widely acknowledged as a problem. The Coalition believes action on adequate funds for administration should not be held hostage to much more divisive political debate over issues such as recipiency rates, extended benefit triggers and solvency levels. In general, HR 3684 provides effective help with recipiency and recession readiness by putting more unemployment tax dollars to work. This means more services for the unemployed, more administrative funding and healthy state trust fund accounts that could be used to improve benefits.

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Thank you for the opportunity to submit this written testimony. In addition, we have attached the following documents: 1) letters of support from Governors and others, 2) press releases from the Coalition and others, 3) a table indicating how much FUTA revenue is returned to the states and a chart indicating funding shortfalls in Texas, 4) newspaper articles regarding the issue, 5) a one-page analysis of HR 3684, and 6) a comparison of HR 3684 and DOL's proposal. We hope the information provided in this statement and the attached materials will prove useful as the Congress continues deliberations on this legislation.

[An attachment is being retained in the Committee files.]

OFFICERS

TRUSTEES

STATEMENT IN SUPPORT OF HR 3684

United States House of Representatives
Ways and Means Committee
Human Resources Sub-Committee

June 19, 1998

The Ohio Grocers Association, through its membership in the Coalition for Employment Security Financing Reform, would like to go on record in support of legislation now before the House Ways and Means Human Resources Sub-Committee to reform the employment security financing system (HR 3684). The Ohio Grocers Association is a trade association representing the entire food industry, from retail grocers to wholesale distributors, manufacturers and suppliers. Our collective membership represents hundreds of employers throughout Ohio.

OGA fully supports the provisions contained in HR 3684 and understands passage of this important legislation would result in a reduction of the federal unemployment taxes Ohio employers currently pay. It also would provide an appropriate level of funding for the employment security system to ensure that those who become unemployed through no fault of their own return to the work force as quickly as possible.

The proposal before you represents a fundamental change in the unemployment insurance tax system by restructuring the Unemployment Trust Fund accounts. The legislation also calls for changes in how program operations are funded, allowing states to provide those services employers and workers both deserve. Additionally, the measure would redefine the respective roles of the states and federal government in the Employment Security system.

OGA supports HR 3684 for the following reasons:

Provides sufficient funding for state programs. Passage of HR 3684 would give individual states sufficient funding to maintain the integrity of unemployment programs. Rather than reducing services and searching for alternative funds, state unemployment programs would be able to concentrate on improving services.

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Federal Unemployment Tax (FUTA) revenue will be used for its intended purpose. All federal fund surpluses will flow directly to state trust funds. Rather than sitting dormant in a federal trust fund, dollars will flow to states where they would be used for program administration or to potentially reduce employer state unemployment taxes.

The burden on employers will be reduced. Employers would no longer pay the "temporary" 0.2 percent surtax, allowing them to invest the savings in other areas of their business, thus stimulating employment and helping local economies. Special state taxes used for program administration would no longer be necessary.

Employers would also deal with one tax collection agency - the state and not the Internal Revenue Service - when dealing with unemployment taxes and reporting. This would result in fewer errors and improved service, potentially saving employers hundreds of millions of dollars.

Length of unemployment will be reduced for many. Strengthening re-employment services means individuals would draw benefits for a shorter period of time, resulting in a savings that could be passed on to employers through a reduction in state unemployment taxes.

Administrative costs will be reduced. Lowering the role of the federal government will free more resources for programs at the state level, or allow funds to be transferred to benefit accounts.

The Coalition for Employment Security Financing Reform believes HR 3684 would not result in a net increase in federal outlays, even though current "pay-go" rules would result in the proposal being scored as an increase in mandatory spending without offsets.

The Ohio Grocers Association, through its affiliation with the Coalition, respectfully urges the House Ways and Means Human Resources Sub-Committee to act favorably on HR 3684 providing better unemployment services at a lower cost to employers in Ohio and throughout the nation.

Statement of the Service Bureau Consortium
to the
Committee on Ways and Means
Subcommittee on Human Resources
regarding the
Employment Security Financing Act of 1998
Submitted for Hearing Record
July 2, 1998

The Service Bureau Consortium ("SBC") represents businesses providing payroll processing and employment tax services directly to employers. SBC members serve more than 600,000 employers and are responsible for more than one-third of the private sector payroll. The following companies are members of SBC: ADP, Inc.; Advantage Payroll, Inc.; Ceridian Corporation; Computing Resources, Inc.; Interpay, Inc.; Paychex, Inc.; Paydata Payroll Services, Inc.; Payroll People, Inc.; Primepay, Inc.; Probusiness Inc.

The tax administration aspects of the Unemployment Insurance ("UI") system are complex, inefficient and costly for employers to administer. This statement highlights the major complexities of current UI tax administration faced by employers and outlines four proposals to address them. The Employment Security Financing Act of 1998 (H.R. 3684) provides for comprehensive restructuring of the UI system. As part of this restructuring, the proposed legislation includes a provision to simplify the collection of the Federal unemployment tax ("FUTA") by giving responsibility for its collection to the state agencies that collect the state unemployment insurance ("SUI") taxes. This provision is consistent with proposals that have been put forth by SBC. The SBC supports the simplification of FUTA collection contained in the bill and recommends that the Subcommittee consider the additional proposals discussed in this statement.

I. Current Tax Collection System

The complexity in the current UI tax collection system is a product of the two-tier process used to collect the

FUTA/SUI tax. This process includes the calculation and payment of the tax at two levels of government, and the determination of an "offset credit" as part of an annual reconciliation of state and Federal UI taxes paid. The collection system is quite inefficient, and the purpose underlying the complex reconciliation process is little understood by employers and no longer necessary for effective program administration.

A. Calculation and Payment

1. Two-Tier Structure. Employers must calculate two separate taxes to finance the unemployment insurance program. Although both Federal tax and state UI taxes are paid quarterly, they are paid on different forms to different tax administrators. Federal payments over $100 must be made as deposits with Form 8109, or via the electronic Federal tax payment system. State taxes are paid as part of a more comprehensive filing that includes submission of all relevant information on quarterly employee wage data. The state-collected wage data is used by both Federal and state governments for administration of UI and other Federal and state programs, such as the Federal Parent Locator Service, for child support enforcement.

2. Definition of Wages. In order to calculate the payment due, an employer must first determine which employees are subject to the tax. The definition of covered wages subject to the tax, however, differs from the Federal government to state governments and among the states. Some states have more expansive definitions of covered wages than the Federal statute. For instance, in Alaska, Connecticut and Hawaii wage definitions cover compensation such as group term life insurance premiums and meals, categories not included in the Federal definition.

Other states, including Washington, have adopted a narrower definition than the Federal definition by optionally excluding corporate officers from the scope of covered employment. Delaware, West Virginia, South Dakota, Michigan and many other states have narrower definitions of covered wages than the Federal statute, excluding compensation such as severance, sick pay and third-party sick pay.

These variations are particularly burdensome for employers, who must make an individual determination as to whether each type of employee income is covered under the

Federal and each applicable state definition. In instances where the state definition is more narrow, employers must recompute the rate of the FUTA tax and increase it to the full (pre-credit) rate.

3. Tax Rates and Wage Bases. Adding further complication to the system, the wage base which is subject to tax and the tax rate itself vary among the Federal government and the 53 jurisdictions that administer the system. The wage base is set at $7,000 for the FUTA tax, but in 1997 only 12 states used the FUTA base to calculate the SUI tax. The remaining jurisdictions use 26 different wage bases with which employers must comply, ranging from $7,700 to $26,000. In addition, the state tax rate applied to the wage base differs from the Federal tax rate. The Federal rate is currently 0.8% while the 1997 state SUI tax rates range from 0% to 12.2%.

4. Other Issues. In addition, states are required to experience-rate the SUI tax; employers with fewer former workers making claims pay lower taxes. While promoting a more equitable distribution of the SUI tax burden among a state's employers, experience rating adds an additional level of complexity to the tax calculation process. The complexity is compounded in the four states that assign experience ratings on a fiscal-year basis, as opposed to a calendar year. Further, some states do not notify employers of their tax rate until two or three months into the new year, creating a significant problem for employers such as contractors who work on a cost-plus basis.

Finally, as many as 20 states also impose add-on taxes to cover costs of state administration not fully reimbursed by the Federal trust fund. These surtaxes differ across states. For example, Georgia imposes a .06% "Administrative Assessment" while Hawaii imposes a .05% "Employment and Training Fund Tax."

B. Offset Credit

1. In General. Under the current tax structure, the 6.2% FUTA tax is reduced by an "offset credit" for states with laws conforming to Federal requirements (currently all 53 UI jurisdictions). The offset credit allows 5.4% of the FUTA tax to be offset by qualifying SUI tax paid with respect to a covered employee. The structure of the offset credit was intended to provide a strong in-

ducement for states to participate in the UI program. The manner in which the credit is calculated on Form 940 also was intended to provide the Federal government sufficient data to impose the full Federal tax on employers in states that fall out of conformity with the program.

2. Administrative Add-on Taxes. In states with add-on taxes, the reconciliation process is further complicated since the Federal offset credit must be calculated using only the amount of the total SUI tax used to pay benefits -- requiring employers to back out the "add-on" tax.

3. Credit Reduction for State Loan Repayment. It should be noted that calculation of the offset credit on Form 940 can become more complex in situations where a state UI loan is in existence. While this repayment mechanism has not been in frequent (and is not in current) use, it remains a complication in the current tax structure.

C. Annual Reconciliation -- Form 940

Employers are required to reconcile their Federal and state UI tax payments annually on Form 940. This form is probably the most complex employment tax form with which employers have to comply. The IRS has estimated that employers take an average of 12 hours and 31 minutes to complete and file the FUTA tax return on Form 940. As noted in the "states'" Administrative Financing Reform Proposal, even assuming a conservative hourly rate of $14, the six million FUTA-paying employers spend more than $1 billion annually to comply with FUTA reporting requirements.

The primary purpose of Form 940 is to allow the Federal government to track what employers would owe if states did not have conforming programs. This determination can be made from the information provided on the first part of the form -- the total amount of wages subject to FUTA. The second part of Form 940, which involves a complex reconciliation of an employer's state and Federal UI tax payments, is not required to impose the full FUTA tax on employers in a potentially non-conforming state.

Moreover, the same information collected from employers in Part II of Form 940 is provided electronically by the states to the IRS in an annual summary by employer of wages reported and UI taxes paid. Finally, the 1996 wel-

fare reform bill (PRWORA) requires the states to report wage information quarterly to the Federal new hire directory. These alternative sources of employee wage information obviate the need to impose the burden of annual reconciliation on employers and allow for the simplification of Form 940.

Form 940 requires employers to make separate entries for each state in which they pay taxes. For each state entry, the employer must make several computations:

- Calculate the covered payroll for each state, using the different definitions of covered employment.
- Set out the experience rate time period for each state. If the rate has changed during the year, the employer must complete a separate sub-entry for each rate time period.
- Set out the experience rate corresponding to each rate period, for every state.
- Calculate the state tax due.
- Calculate the difference between the state tax due and the potential FUTA tax credit amount (5.4%).
- Set out the state tax actually paid by the due date of the FUTA return, excluding any add-on taxes.
- Make several other calculations and comparisons to arrive at the tentative credit.

Ironically, the complex process involved in filling out Form 940 rarely, if ever, changes the total amount of Federal tax employers must pay. However, to the extent that an employer has not timely paid all state UI taxes owed by the filing deadline for Form 940, the offset credit is reduced. As a result, failure to fully pay state taxes results in an increase in the total Federal tax paid. This result is both complex and, to a certain extent, illogical.

D. State and Federal Audits

The UI taxes employers pay are subject to audit by both the Internal Revenue Service and the state agency responsible for SUI tax administration. States administer most of the auditing. State audit results are shared with the IRS, which typically will issue a Federal employment tax notice to employers found to be underpaying at the state level. State referrals of audit issues account for most Federal employment tax "audits."

II. Four Proposals to Simplify UI Tax Administration

As highlighted in the previous section, compliance with the current UI tax system is a very complex process for employers. The following four proposals would address some of these issues.

A. Pay all FUTA/SUI taxes quarterly to state administrator, as provided in the proposed legislation.

Currently, employers must pay taxes each quarter to two separate sources. Since employers must report wage information to the states quarterly in addition to paying the tax, mandating quarterly payments of all taxes and wage record reporting to the state employment security agency only will dramatically streamline the collection and audit process and should improve both accuracy and compliance. While there are Federal/state coordination issues that must be addressed (for example, partial payments and Federal vs. state statutory protection of taxpayers), these issues can be addressed through careful statutory drafting and granting the requisite authority to Federal agencies to enter into agency agreements with the states.

B. Standardize the definition of covered employment for FUTA/SUI purposes.

As highlighted above, there are many minor differences in definitions of covered employment between the Federal

government and the states, and among the states. A key element of UI tax administration reform would be to mandate the use of the FUTA definition of covered employment as the standard for all states. This would represent a major reduction in the amount of complexity for employers without materially changing the nature or scope of state UI programs.

C. Provide states flexibility to incorporate FUTA tax in state SUI rate/base structure.

Allowing states to determine the amount of the FUTA "tax rate" in the context of the state wage base (i.e., states would set rate at a level projected to raise same amount of revenue when applied to state wage base as a .8% (.6% under the proposed legislation) tax would against a $7,000 base) would further reduce the tax calculation complexity burden of current law. Such a reform would allow states to incorporate the Federal FUTA obligation into the state tax rate/wage base structure. Melding the Federal and state tax structures would obviate the use of the offset credit as a compliance mechanism. However, standardizing the FUTA/SUI employment definitions with an appropriate compliance process would ensure coverage of mandated employment groups with significantly less burden to employers.[1] Such a change also provides the opportunity to allow the Federal tax component to be included in a state's experience-rating system. This approach could only approximate the revenues of the current FUTA tax and it would result in varying levels of progressivity depending on the taxing jurisdiction's SUI wage base. Nonetheless, the value of eliminating the complex scheme that now subjects employers in 41 of 53 jurisdictions to a dual wage base calculation for Federal/state UI taxes far outweighs these relatively minor implementation issues. States already exercise considerable latitude in setting benefit levels and tax regimes; they are well-equipped to assume this additional responsibility.

[1] An alternative mechanism for ensuring that states remain in compliance would need to be adopted. For example, nonconforming states could be made ineligible for administrative payments.

D. Eliminate the offset credit calculation and otherwise simplify Form 940.

States already supply sufficient wage data to the IRS electronically to allow the Federal government to impose the full FUTA tax on a state's employers if a state opted out of the UI system. Furthermore, if states are charged with collecting and auditing both components of the UI tax, Form 940 reconciliation would not be necessary as a compliance cross-check. The tedious required reconciliation calculation involving the offset credit does not represent a benefit worth the cost of compliance. A simplified Form 940 (i.e., omitting Part II) could provide the IRS with all the information, it needs and significantly reduce the reporting burden for employers.

The SBC appreciates the opportunity to present its views to the Subcommittee. The SBC believes that the consideration of comprehensive restructuring of the UI system offers an important opportunity to simplify the tax administration aspects of the system. The SBC supports the simplification of FUTA collection contained in H.R. 3684 and looks forward to working with the Subcommittee on this and other tax administration issues as the legislative process continues.